No. 17436

United States Court of Appeals

for the Ninth Circuit

WEYERHAEUSER STEAMSHIP COMPANY,

Appellant,

vs.

THE UNITED STATES OF AMERICA,

Appellee.

Transcript of Record

Appeal from the United States District Court for the Western District of Washington, Southern Division.

Phillips & Van Orden Co., 4th & Berry, S. F., Calif.—Rec. 7-27-61—Printed 8-22-61

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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ATTORNEYS OF RECORD

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CHARLES P. MORIARTY,
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For Defendant-Appellee.

In the District Court of the United States for the Western District of Washington, Southern Division

No. 2483

WEYERHAEUSER STEAMSHIP COMPANY,

Plaintiff,

vs.

THE UNITED STATES OF AMERICA,

Defendant.

COMPLAINT

I.
Nature of Action and Statement of Jurisdiction

Plaintiff brings this action against the United States of America for the recovery of income tax and interest thereon illegally and erroneously assessed and collected from plaintiff for the calendar year ending December 31, 1954 (hereinafter referred to as taxable year 1954). Jurisdiction is conferred upon this Court by virtue of the provisions of Title 28, United States Code, Section 1346(a)(1).

II.
Statement of Facts Applicable to Claim

The facts upon which plaintiff's claim is based are as follows:

(a) Plaintiff is a corporation duly organized under the laws of the State of Delaware on October

16, 1933, with its principal place of business at Tacoma, Washington.

(b) In 1954, plaintiff owned eight dry cargo Liberty Class ships, all in United States registry. Under the market conditions then prevailing, the ships were worth substantially more under foreign registry. In order to permit the transfer of ships to foreign registry, but in limited numbers, the United States Maritime Commission on August 17, 1954, promulgated its "one-for-one" policy. This policy permitted transfer of one ship to foreign registry upon condition that a commitment be made to the Commission, by either the transferor or another shipowner, to retain another ship permanently in United States registry. Because of the increased value of ships transferred to foreign registry, substantial amounts were paid by prospective transferors to shipowners who permanently gave up the right to transfer a ship to foreign registry. Plaintiff executed commitments to perpetually retain four ships in United States registry, and received as consideration therefor the sum of $291,437.50 from other owners of ships who were thereby enabled to transfer four ships to foreign registry. The payor companies, the amounts received for each letter of commitment, and the ships committed are set forth in summary form in Exhibit A attached hereto.

(c) On or about July 15, 1955, plaintiff duly filed its Corporation Income Tax Return for the taxable year 1954 with the Director of Internal

Revenue at Tacoma, Washington, which Return disclosed a net loss. Thereafter, on or about December 15, 1955, plaintiff filed Form 2175, entitled "Statement to be Filed Pursuant to Repeal of Sections 452 and 462 of the Internal Revenue Code of 1954," which Statement disclosed a tax liability for taxable year 1954 in the amount of $10,159.30. A copy of the Return and Statement, together with supporting schedules, is attached hereto as Exhibit B. Said tax liability was fully discharged by payment of the sum of $10,159.30 to said Director of Internal Revenue.

(d) In computing its tax liability, the amount received for the sale of its right to transfer the four ships involved to foreign registry was applied by plaintiff in reduction of the basis of such ships, and was reflected in the depreciation schedules attached to its Returns. No gain was recognized under Section 1001 of the Internal Revenue Code of 1954 because the amounts so received were less than the respective bases of the ships involved.

(e) In a Notice of Deficiency dated December 12, 1958, a copy of which is attached hereto as Exhibit C, the Internal Revenue Service made demand upon plaintiff for additional tax for the taxable year 1954 in the amount of $152,375.28, plus interest thereon. Of said amount, $151,547.50 plus interest of $34,013.07 was predicated upon an erroneous determination that plaintiff had not sold or exchanged capital assets when it engaged in the transactions described in subparagraph (b) above. Said amount

of $151,547.50 represents the additional tax payable if the $291,437.50 received for the commitment letters is properly includible in ordinary income.

(f) Plaintiff complied with said Notice of Deficiency on or about December 23, 1958, by the payment of $152,375.28 additional tax plus interest thereon of $34,198.86, for a total payment of $186,584.14, to the Director of Internal Revenue at Tacoma, Washington. Subsequently, additional interest in the amount of $275.52 was assessed and paid (Exhibit D attached hereto). Of the amounts paid, $151,547.50 represents additional tax and $34,287.10 interest with respect to the letters of commitment transactions. The balance of the tax and interest paid is not in dispute.

(g) On or about February 27, 1959, plaintiff filed with the Director of Internal Revenue at Tacoma, Washington, a claim for refund of tax and interest in the total amount of $186,859.18 theretofore paid in compliance with the aforesaid Notices of Deficiency, and therein demanded the refund of said amount, together with interest as provided by law. A copy of said claim for refund, together with supporting schedule showing the basis thereof, is attached hereto as Exhibit E. As set forth in the preceding paragraph, only $185,834.60 is in issue in this action.

(h) On or about June 30, 1959, plaintiff received a registered Notice of Disallowance of Claim for Refund from the Director of Internal Revenue

Service at Tacoma, Washington, a copy of which notice is attached hereto as Exhibit F. This suit is timely filed, being less than two years after such receipt.

Wherefore, with respect to the letters of commitment transactions, plaintiff prays for judgment against the defendant, United States of America, in the amount of $185,834.60, together with interest thereon as provided by law, and for such other and further relief as the Court may deem proper.

In the alternative, if some portion of the basis of the four ships to which the commitment letters relate is properly allocable to the respective commitment letters, plaintiff prays for judgment against the defendant, United States of America, in such amount as represents the tax computed under Section 1201 of the Internal Revenue Code of 1954 upon the excess of the amounts received for each commitment letter over the basis properly allocable thereto.

/s/ DANIEL C. SMITH,

/s/ OLIVER MALM,

/s/ RICHARD K. QUINN,

Attorneys for Plaintiff.

Duly verified.

[Endorsed]: Filed November 25, 1959.

[Title of District Court and Cause.]

ANSWER

For answer to the complaint filed herein, defendant admits, denies, and states as follows:

1. Denies paragraph 1, except admits that jurisdiction is invoked under Section 1346(a)(1) of Title 28, United States Code.

2(a). Lacks information sufficient to form a belief as to the truth of the allegations set forth in paragraph 2(a).

2(b). Lacks information sufficient to form a belief as to the truth of the allegations set forth in paragraph 2(b).

2(c). Admits paragraph 2(c), except denies that the amount of tax liability reported and paid was a true tax liability due defendant.

2(d). Lacks information sufficient to form a belief as to the truth of the allegations set forth in paragraph 2(d).

2(e). Denies paragraph 2(e), except admits that a Notice of Deficiency was mailed on or about December 12, 1958, and that Exhibit C is a true copy thereof.

2(f). Admits paragraph 2(f), except lacks information at this time as to whether the balance of the tax and interest paid is in dispute.

2(g). Admits paragraph 2(g), except denies any statement of fact set forth in the claim for refund,

Exhibit E, which is not otherwise expressly admitted in this answer, and further denies for lack of information sufficient to form a belief at this time that the amount of $185,834.60 is the only issue in this action.

2(h). Admits paragraph 2(h).

Wherefore, defendant asks for judgment in its favor together with costs as allowable by law.

Dated: January 15, 1960.

CHARLES P. MORIARTY,
United States Attorney;

/s/ CHARLES W. BILLINGHURST,
Assistant U. S. Attorney.

[Endorsed]: Filed January 19, 1960.

[Title of District Court and Cause.]

PRETRIAL ORDER

As the result of pretrial conferences heretofore had, whereat the plaintiff was represented by Richard K. Quinn, and the defendant by Charles H. Magnuson of the Department of Justice, their attorneys of record, the following issues of fact and law were framed and exhibits identified.

Admitted Facts

I.

This civil action is brought under U.S.C. Title 28, Section 1346(a)(1), as amended, for the re-

covery of income tax and interest assessed by the Commissioner of Internal Revenue against and paid by plaintiff to defendant under the Internal Revenue Code of the United States for the taxable calendar year 1954.

II.

Plaintiff, a corporation duly organized under the laws of the State of Delaware on October 16, 1933, has maintained its principal place of business at Tacoma, Washington, since the date of incorporation up to and including the date hereof. During all of said years, it has filed its Federal tax returns with the Director of Internal Revenue at Tacoma, Washington.

III.

Plaintiff, during the year 1954 and during years prior and subsequent thereto, has engaged in the business of operating a dry cargo steamship fleet in intercoastal trade. As a steamship operator, it is the owner of a number of vessels. During 1954, it owned seven dry cargo Liberty-type vessels, each of which was owned by plaintiff for more than six months prior to the beginning of that year, and each of which was documented under the laws of the United States, and, as such, was an American Flag vessel as required by law for vessels operating in intercoastal trade.

IV.

Sections 9 and 37 of the Shipping Act of 1916, as amended (U.S.C. Title 46, Sections 808 and 835), give rise to the authority under which the Secretary of Commerce, acting through the Maritime Ad-

ministration, exercised control over transfers of vessels documented under the laws of the United States prior to, during the taxable year 1954, and up to and including the date hereof.

V.

Pursuant to such authority, on August 16, 1954, the Maritime Administration promulgated a transfer policy and formula to be used in connection therewith whereby favorable consideration was given to permitting the transfer of a number of dry cargo Liberty-type vessels to foreign registry and flag. (Statement of policy issued August 25, 1954, by Director, Office of National Shipping Authority and Government Aid, outlining formal policy adopted by Maritime Administrator on August 16, 1954, a copy of which is attached hereto and marked "Pretrial Exhibit No. 1.") On December 17, 1954, the Maritime Administration rescinded this policy. (Press release issued December 17, 1954, by Louis S. Rothschild, Maritime Administrator, a copy of which is attached hereto and marked "Pretrial Exhibit No. 2.")

VI.

During the taxable year 1954, plaintiff agreed to retain four of its dry cargo Liberty-type vessels in United States registry in accordance with the then existing Maritime Administration transfer policy in order to permit the owners of four vessels to transfer such vessels to foreign registry for use as foreign flag vessels. For the Court's convenience, a chronological summary of plaintiff's written agree-

ments (herein called collectively "agreements of retention" or "retention agreements") with respect to its vessels follows:

a. Pursuant to an agreement with Intercontinental Steamship Corporation, plaintiff delivered to the Maritime Administration a letter dated November 5, 1954, agreeing to retain its vessel, the W. H. Peabody, in United States registry. This qualified Intercontinental Steamship Corporation to transfer its vessel, the Holystar, to foreign registry. Formal approval by the Maritime Administration of the transfer of the Holystar to Liberian registry was given by Transfer Order dated December 2, 1954. (Copies of the agreement between plaintiff and Intercontinental Steamship Corporation, plaintiff's letter to the Maritime Administration, and the Transfer Order are attached hereto and marked "Pretrial Exhibit No. 3.")

b. Pursuant to an agreement with Marine Shipping, Inc., plaintiff delivered to the Maritime Administration a letter dated November 8, 1954. agreeing to retain its vessel, the F. E. Weyerhaeuser, in United States registry. This qualified Marine Shipping, Inc., to transfer its vessel, the Christos M., to foreign registry. Formal approval by the Maritime Administration of the transfer of the Christos M. to Liberian registry was given by Transfer Order dated December 2, 1954. (Copies of the agreement between plaintiff and Marine Shipping, Inc., plaintiff's letter to the Maritime Administration,

and the Transfer Order are attached hereto and marked "Pretrial Exhibit No. 4.")

c. Pursuant to an agreement with International Navigation Company, Inc., plaintiff delivered to the Maritime Administration a letter dated December 14, 1954, agreeing to retain its vessel, the John Weyerhaeuser, in United States registry. This qualified International Navigation Company, Inc., to transfer its vessel, the Marven, to foreign registry. Formal approval by the Maritime Administration of the transfer of the Marven to Liberian registry was given by Transfer Order dated December 22, 1954. (Copies of the agreement between plaintiff and International Navigation Company, Inc., plaintiff's letter to the Maritime Administration, and the Transfer Order are attached hereto and marked "Pretrial Exhibit No. 5.")

d. Pursuant to an agreement with Global Tramp, Inc., plaintiff delivered to the Maritime Administration a letter dated December 24, 1954, agreeing to retain its vessel, the Geo. S. Long, in United States registry. This qualified Global Tramp, Inc., to transfer its vessel, the Ocean Skipper, to foreign registry. Formal approval by the Maritime Administration was given by Transfer Order dated December 31, 1954. (Copies of the agreement between plaintiff and Global Tramp, Inc., plaintiff's letter to the Maritime Administration, and the Transfer Order are attached hereto and marked "Pretrial Exhibit No. 6.")

VII.

As consideration for its retention agreements, plaintiff received the sum of $291,437.50 from the owners of the four vessels transferred to foreign registry. The payor companies, the amounts received by plaintiff, and the vessels of plaintiff in respect of which such amounts were received are set forth below:

Payor Company	Amount Received	Vessel
Intercontinental Steamship Corporation ..... c/o Triton Shipping, Inc. 80 Broad Street, New York, N. Y.	$ 79,281.25	W. H. Peabody
Marine Shipping, Inc. ..... c/o Triton Shipping, Inc. 80 Broad Street, New York, N. Y.	79,281.25	F. E. Weyerhaeuser
International Navigation Company, Inc. ..... 52 Broadway, New York, N. Y.	66,500.00	John Weyerhaeuser
Global Tramp, Inc. ..... 52 Broadway, New York, N. Y.	66,375.00	Ocean Skipper
	$291,437.50	

VIII.

In computing its Federal income tax liability for the taxable year 1954, plaintiff treated the payments received for retaining its vessels in United States registry as receipts from the sale to others of its rights to foreign transfer in these four vessels and reported the receipts on Schedule D of its Return for the taxable year 1954. Believing that it had sold property rights relative to four of its vessels and that such sale was governed by the provisions of

Section 1231 of the Internal Revenue Code of 1954 and that no part of the basis of any vessel was allocable to the rights sold, it reported no gain from the sale of such rights but applied the receipts in reduction of the tax basis of the respective vessels. This treatment was disallowed by the Commissioner of Internal Revenue and was determined by him to be the receipt of ordinary income.

IX.

1. On or about July 15, 1955, plaintiff duly and timely filed its Corporation Income Tax Return for the taxable calendar year 1954 with the Director of Internal Revenue at Tacoma, Washington, which Return disclosed a net loss. Thereafter, on or about December 15, 1955, plaintiff filed Form 2175, entitled "Statement to Be Filed Pursuant to Repeal of Sections 452 and 462 of the Internal Revenue Code of 1954," which Statement disclosed a tax liability for the taxable year 1954 in the amount of $10,159.30. (A copy of the Return and Statement, together with supporting schedules, is attached as Exhibit B to plaintiff's Complaint in this cause and is incorporated herein by reference.) Said tax liability was fully discharged by payment thereof to said Director of Internal Revenue.

2. In a Notice of Deficiency dated December 12, 1958 (a copy of which is attached as Exhibit C to plaintiff's Complaint in this cause and is incorporated herein by reference), the Internal Revenue Service made demand upon plaintiff for additional

tax for the taxable year 1954 in the amount of $152,-375.28, plus interest thereon. Of said amount, $151,-547.50, plus interest of $34,013.07 represents the additional tax and interest payable if the $291,-437.50 received as a result of the retention agreement transactions is properly includible in ordinary income.

3. Plaintiff complied with said Notice of Deficiency on or about December 23, 1958, by payment to the Director of Internal Revenue at Tacoma, Washington, of $152,375.28 additional tax, plus interest thereon of $34,198.86, for a total payment of $186,574.14. Subsequently, additional interest in the amount of $275.52 was assessed and paid to the Director (Exhibit D attached to plaintiff's Complaint in this cause and incorporated herein by reference). Of the amounts paid $151,547.50 represents additional tax and $34,287.10 interest with respect to the retention agreement transactions and are the amounts at issue in this cause. The balance of the tax and interest paid is not in dispute.

4. On or about February 27, 1959, plaintiff filed with the Director of Internal Revenue at Tacoma, Washington, a claim for refund of tax and interest in the total amount of $186,859.18 theretofore paid in compliance with the aforesaid Notices of Deficiency, and therein demanded the refund of said amount, together with interest as provided by law. (A copy of said Claim for Refund, together with supporting schedule showing the basis thereof, is attached as Exhibit E to plaintiff's Complaint in

this cause and is incorporated herein by reference. Defendant denies each statement contained therein except those herein expressly admitted.) As set forth in the preceding paragraph, only $185,834.60 is in issue in this cause.

5. On or about June 30, 1959, plaintiff received a registered Notice of Disallowance of Claim for Refund from the Director of Internal Revenue at Tacoma, Washington. (A copy of said notice is attached as Exhibit F to plaintiff's Complaint in this cause, and is incorporated herein by reference.) Plaintiff's suit is timely filed, being less than two years after such receipt.

Plaintiff makes the following contentions, each of which is denied by defendant:

Plaintiff's Contentions

1. Sections 9 and 37 of the Shipping Act of 1916, as amended (U.S.C. Title 46, Sections 808 and 835), require the owner of vessels documented under the laws of the United States to obtain prior approval of the Maritime Administration as a condition of transferring either (1) ownership of such vessels to non-citizens, or (2) registry of such vessels to foreign countries. These sections constitute part of a co-ordinated plan devised by Congress to foster and develop a strong American merchant marine in the interests of national security and economy. Their basic purpose is to restrict the transfer of vessels to aliens where such vessels are or may be required for the transportation of cargo

in the foreign and domestic commerce of the United States and for its national defense. They restrict the transfer of vessels which, but for factors peculiar to their special utility in the national economy and defense, would be freely sold or transferred as is other private property. Administration of these sections has been marked with high regard for the status accorded to property rights in the United States Constitution and with recognition of the need for self-restraint in the exercise of the broad authority conferred therein, any arbitrary exercise of which would be inconsistent with the American concept of the rights of private property. (Statement, March 24, 1954, by Louis S. Rothschild, Maritime Administrator, a copy of which is attached hereto and marked "Pretrial Exhibit No. 7.")

2. Consistent with its recognition that the right to transfer or sell vessels without restriction is a valuable property right which may be restrained only where careful deliberation reveals that the paramount interests of national security compel it, the Maritime Administration, during the years prior to August 16, 1954, approved or disapproved of applications for transfer of vessels to foreign registry on a case-by-case basis. In reviewing these applications, consideration was given to a number of factors respecting transfer, including factual data regarding the vessel involved, the effect upon the maintenance of an adequate merchant marine, the effect upon the national defense, and the impact

upon the owner and its employees. (Pages 7-9, Pretrial Exhibit No. 7.)

3. The Maritime Administration adopted its new "one-for-one" transfer policy on August 16, 1954, in recognition of the serious financial difficulties confronting American owners of dry cargo Liberty-type vessels due to their inability to obtain profitable employment for their vessels in competition with low-cost foreign flag operators (Pretrial Exhibit No. 2).

4. The Maritime Administration in years subsequent to December 17, 1954, has continued to recognize the owner's right to transfer and sell vessels except where the interests of national security and economy intervene. (Press release issued November 9, 1955, by Clarence G. Morse, Maritime Administrator, a copy of which is attached hereto and marked "Pretrial Exhibit No. 8.")

5. The right to transfer or sell vessels has been recognized at all times by the United States Maritime Administration as a valuable property right inherent in the ownership of such vessels.

6. When plaintiff executed its retention agreements, dry cargo Liberty-type vessels were worth substantially more in foreign registry than when registered under the American Flag. A primary cause of this difference in value was the marked difference in operating costs between foreign and domestic flag vessels. (Page 8 of the Report of the Water Transportation Subcommittee of the Senate

Committee on Interstate and Foreign Commerce Concerning Whether the Maritime Administrator Has Been Administering Improperly the Law Dealing With Foreign Transfers of American Flag Vessels, a copy of which is attached hereto and marked "Pretrial Exhibit No. 9.") As a consequence of this difference in value, an agreement to retain a vessel in United States registry decreased the value of such vessel, or, alternatively, a vessel to which an agreement of retention had not been executed and which was still available for transfer to foreign registry enjoyed a substantial enhancement in value.

7. By engaging in the retention agreement transtions, plaintiff sold the rights to foreign transfer in four of its vessels, and thereby barred the foreign transfer of such vessels. Subsequent to the cancellation by the Maritime Administration of its "one-for-one" policy on December 17, 1954, plaintiff's obligations to the Maritime Administration to retain the vessels involved in United States registry remained in effect and continued to adversely affect the market value of such vessels.

8. One of the rights, privileges, powers, and immunities inherent in the ownership of any property is the right to sell or otherwise transfer such property. The right to transfer a vessel to foreign registry is a valuable property right which attaches to the ownership of such vessel.

9. In executing the retention agreements, plaintiff sold to others its rights to transfer foreign in

four of its vessels and was thereby entitled to treat the amounts realized as proceeds from the sale of property used in the trade or business and held for more than six months within the meaning of Section 1231 of the Internal Revenue Code of 1954. As no part of the basis of any of the four vessels was allocable to the rights of transfer that were sold, plaintiff properly applied the proceeds of sale as reductions in the respective basis of the vessels involved.

10. Alternatively to the last sentence of the preceding paragraph, if some portion of the basis of each of the four vessels to which the retention agreements relate is found by this Court to be properly allocable to the property rights sold in the respective retention agreements, then the amounts received in excess of the respective bases are entitled to capital gains treatment as receipts from the sale of property used in the trade or business and held for more than six months under Section 1231 of the Internal Revenue Code of 1954.

Defendant makes the following contentions, each of which is denied by plaintiff:

Defendant's Contentions

1. The income tax deficiency assessed by the Commissioner of Internal Revenue and collected from the plaintiff for the taxable year 1954 was proper and no refund is due under the claims asserted in this action.

2. The presumption favoring the correctness of the Commissioner's assessment is fully supported by the facts and law material to this case.

3. The transactions involved in this action did not result in the sale or exchange of property, capital assets or property used in the taxpayer's trade or business within the meaning of Sections 1221 and 1231 Internal Revenue Code of 1954.

4. The payments received by the plaintiff from the various vessel owners for the right to use vessels under foreign registry results in compensation to be treated as ordinary income within the meaning of the Internal Revenue Code.

5. The payments received by the plaintiff for its agreements to retain its vessels in American registry results in compensation to be treated as ordinary income within the meaning of the Internal Revenue Code.

6. Plaintiff's agreements to retain its vessels in American registry were voluntary restrictions of the use of property for which the taxpayer was compensated and the compensation is to be treated as ordinary income.

7. The amounts received by plaintiff under its retention agreements did not reduce the bases of plaintiff's vessels.

8. The lawful act of the Maritime Administration in restricting the right to use property does not cause the basis of such property to be reduced.

9. In viewing transactions for income tax purposes the Court must look to the substance of the acts rather than the terms of the forms used.

10. This action falls within the full meaning and intent of Revenue Ruling 58-296 (1958-1 C.B. 276) which provides:

"Payments received for agreements to retain ships under American registry procured for the purpose of enabling the payors to meet the requirements of the Maritime Administration under the temporary policy in effect between August 16, 1954, and December 17, 1954, so as to be able to transfer like ships to foreign registry, constitute ordinary income and not capital gain. Such an agreement does not constitute a sale or exchange of property. The privilege passing under the agreement is a temporary privilege created and suspended by administrative action of a governmental agency and does not constitute property within the purview of Section 1221 of the Internal Revenue Code of 1954."

Issues of Fact

The following is the issue of fact to be determined by the Court herein:

1. Whether during the taxable year in question and during years subsequent thereto, the market value of dry cargo Liberty-type vessels was substantially reduced as a result of retention agreements, or, alternatively, the market value of dry cargo Liberty-type vessels to which agreements of

retention had not been executed and which were still available for transfer to foreign flag was substantially enhanced.

Issues of Law

The following are the issues of law to be determined by the Court herein:

1. Whether the amounts received by plaintiff as a result of its retention agreements constitute amounts received for the sale of property used in the trade or business and held for more than six months within the meaning of Section 1231 of the Internal Revenue Code of 1954 (as plaintiff contends), or constitute the receipt of ordinary income (as defendant contends).

2. Whether or not a portion of the basis of each of the four vessels to which the agreements of retention relate is properly allocable to the right to transfer to foreign registry.

Stipulation

The parties hereto have agreed as follows:

1. By this Pretrial Order, the parties have attempted to narrowly confine the issues before this Court. If, in reaching a decision on the stated issues of fact and law, it should be necessary for the Court to make separate determinations of fact and law, with respect to peripheral matters, the parties hereto, with the Court's approval, reserve the right to formally express their views with respect to such issues.

2. Should it be necessary, and with the Court's approval, the parties agree to submit a computation of the amount, if any, due plaintiff in accordance with the Court's determination in this cause.

Exhibits

The exhibits of the parties were produced and marked and may be received in evidence, if otherwise admissible, without further identification, it being admitted that each exhibit is what it purports to be. Each party waives the objection that any such exhibit is a copy rather than an original. A list of the said exhibits of both parties is hereto attached to the Pre-Trial Order and made a part hereof by reference.

Plaintiff's Exhibits

1. Statement of policy issued August 25, 1954, by Director, Office of National Shipping Authority and Government Aid, outlining formal policy adopted by Maritime Administrator on August 16, 1954.

2. Press release issued December 17, 1954, by Louis S. Rothschild, Maritime Administrator.

3. Agreement between plaintiff and Intercontinental Steamship Corporation respecting retention of the W. H. Peabody in United States registry, plaintiff's letter to the Maritime Administration, and the Maritime Administration Transfer Order authorizing transfer of the Holystar to foreign registry.

4. Agreement between plaintiff and Marine Shipping, Inc., respecting retention of the F. E. Weyerhaeuser in United States registry, plaintiff's letter to the Maritime Administration, and the Maritime Administration Transfer Order authorizing transfer of the Christos M. to foreign registry.

5. Agreement between plaintiff and International Navigation Company, Inc., respecting retention of the John Weyerhaeuser in United States registry, plaintiff's letter to the Maritime Administration, and the Maritime Administration Transfer Order authorizing transfer of the Marven to foreign registry.

6. Agreement between plaintiff and Global Tramp, Inc., respecting retention of the Geo. S. Long in United States registry, plaintiff's letter to the Maritime Administration, and the Maritime Administration Transfer Order authorizing transfer of the Ocean Skipper to foreign registry.

7. Statement of March 23, 1954, by Louis S. Rothschild, Maritime Administrator.

8. Press release issued November 9, 1955, by Clarence G. Morse, Maritime Administrator.

9. Report of the Water Transportation Subcommittee of the Senate Committee on Interstate and Foreign Commerce Concerning Whether the Maritime Administrator Has Been Administering Improperly the Law Dealing with Foreign Transfers of American-Flag Vessels.

Exhibits B, C, D, E, and F, incorporated in this Pre-Trial Order by reference, are marked and attached to the plaintiff's Complaint on file herein.

Action by the Court

The Court has ruled that:

The foregoing Pre-Trial Order has been approved by the parties hereto as evidence by the signatures of their counsel hereon and by the entry of this Order the pleadings pass out of the case. This Pre-Trial Order shall not be amended except by Order of the Court pursuant to agreement of the parties or to prevent manifest injustice.

Dated at Tacoma, Washington, this 17th day of October, 1960.

/s/ GEO. H. BOLDT,
United States District Judge.

Approved for entry:

/s/ DANIEL C. SMITH,

/s/ OLIVER MALM,

/s/ RICHARD K. QUINN,
Attorneys for Plaintiff.

/s/ CHARLES H. MAGNUSON,
Attorney for Defendant.

[Endorsed]: Filed October 20, 1960.

[Title of District Court and Cause.]

MEMORANDUM DECISION

The money payments received by plaintiff, on which capital gain tax treatment is claimed, were agreed consideration for plaintiff's commitment to the payors not to apply for transfer foreign of specified Liberty ships owned by plaintiff during continuance of a certain ship transfer policy of the United States Maritime Administration. At the time the right to apply for transfer foreign was a valuable incident of the ownership of plaintiff's ships and as such it was a property right.

The question for decision is whether the relinquishment, or forbearance in exercise, of such right was a "sale or exchange of property" qualifying income derived therefrom for capital gain treatment under §1231 of the Internal Revenue Code of 1954. Unless the transactions fully met the requirements of that section the funds thus acquired were ordinary income as defined generally in §61 of the Internal Revenue Code of 1954 and more particularly in subsection (a)(3) of that section: "gains derived from dealings in property."

In the light of legislative intent and purposes stated and applied in the following cited decisions, the property right referred to is not "property" as that term is used in §1231; nor, within the meaning of that section, is a covenant to forbear excercise of such right a "sale or exchange of property," or the equivalent thereof. Commissioner v. Gillette Motor Co., 364 U.S. 130 (1960); Corn Products Co. v. Commissioner, 350 U.S. 46 (1955); Com-

missioner v. Glenshaw Glass Co., 348 U.S. 426 (1955); Leh v. Commissioner, 260 F. 2d 489 (9th Cir. 1958); Clover v. Commissioner, 143 F. 2d 570 (9th Cir. 1944); Ullman v. Commissioner, 264 F. 2d 305 (2nd Cir. 1959); Terminal Steamship Co. v. Commissioner, 34 T.C. No. 94 (1960). This Court finds nothing persuasive to the contrary in the decisions relied on by plaintiff: Hort vs. Commissioner, 313 U.S. 28 (1941); Metropolitan Building Co. v. Commissioner, 282 F. 2d 592 (9th Cir. 1960); Commissioner v. Ray, 210 F. 2d 390 (5th Cir. 1954); Commissioner v. McCue Bros. & Drummond, Inc., 210 F. 2d 752 (2nd Cir. 1954); Commissioner v. Golonsky, 200 F. 2d 72 (3rd Cir. 1952); Warren v. Commissioner, 193 F. 2d 996 (1st Cir. 1952); Anton L. Trunk, 32 T.C. 1127 (1959); Hamilton & Main, Inc., 25 T.C. 878 (1956); Inaja Land Co., Ltd., 9 T.C. 727 (1947).

However designated by the parties thereto and whatever some of the legal characteristics thereof, the transactions under consideration by essential nature are not within the strictly limited category specified by statute for capital gain treatment in the computation of income tax.

Findings of fact, conclusions of law and judgment as proposed by defendant have this date been signed by the court and forwarded to the clerk for entry.

Dated this 17th day of March, 1961.

/s/ GEO. H. BOLDT,
United States District Judge.

[Endorsed]: Filed March 20, 1961.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This case having come on for trial before this Court on November 17, 1960, and the Court having heard the evidence adduced by the parties and having considered the stipulation of facts contained in the pretrial order dated October 17, 1960, and having entered a memorandum decision made a part hereof, hereby makes the following findings of fact and conclusions of law:

Findings of Fact

1. This is a civil action brought under Title 28 U.S.C., Section 1346(a)(1) for the recovery of income tax and interest assessed by the Commissioner of Internal Revenue against and paid by plaintiff to defendant under the Internal Revenue Code of the United States for the taxable calendar year 1954.

2. Plaintiff, a corporation duly organized under the laws of the State of Delaware on October 16, 1933, has maintained its principal place of business at Tacoma, Washington, from the date of incorporation up to and including the date hereof. During all of the said years it has filed its federal income tax returns with the District Director of Internal Revenue at Tacoma, Washington.

3. Plaintiff, during the year 1954 and during the years prior and subsequent thereto, has engaged in the business of operating a dry cargo steamship fleet in intercoastal trade. As a steamship operator, it is the owner of a number of vessels. During the year 1954, it owned and operated seven dry cargo Liberty type vessels, each of which was owned by plaintiff for more than six months prior to the beginning of that year, and each of which was documented under the laws of the United States, and, as such, was an American flag vessel as required by law for vessels operating in intercoastal trade.

4. Under Sections 9 and 37 of the Act of September 7, 1916, Chapter 451, 39 Stat. 728, as amended (46 U.S.C. 1958 Ed., Sections 808 and 835), the Secretary of Commerce, acting through the Maritime Administration, exercised control over the transfers of vessels documented under the laws of the United States. It was within the power of the Maritime Administration to withhold the privilege of a ship owner to transfer its vessels to a foreign registry. However, until August 16, 1954, it was its policy to decide each application for transfer of a vessel on its own merits, using no specific rigid policy. In deciding whether to permit a ship owner to transfer the vessel foreign, the Maritime Administration would consider such factors as the needs of our national defense, the life expectancy of the vessel, the need to attract private financing, the possibility of vessel replacement, the character of the vessel, the character of the transferee and other factors related to the national welfare.

5. Prior to the period beginning August 16, 1954, Weyerhaeuser operated all of its Liberty vessels in intercoastal trade. In order for each of Weyerhaeuser's vessels to engage in intercoastal trade, each such vessel was required to be registered under the American flag. Once a vessel was transferred to a foreign registry, it was disqualified from ever again engaging in intercoastal trade, and this disqualification remained permanent even if the ship was later returned to American registry. If Weyerhaeuser had ever transferred a vessel foreign, it could, therefore, never use that vessel again in intercoastal trade. As a result, it was not interested in transferring its ships to foreign registry, nor did it ever apply for a transfer foreign. When negotiating for the purchase of its Liberty ships, it gave no thought to foreign operations, nor did it attribute any value to the use of those ships under foreign registry. Instead of exercising its privilege to request transfer foreign for any or all of its seven Liberty vessels, Weyerhaeuser chose to use its Liberty vessels solely under United States registry during the entire time it owned them.

6. On August 16, 1954, the Maritime Administration changed its policy and adopted the rigid so-called "one-for-one" policy, which, in turn, was subsequently terminated approximately four months later in December, 1954. Under this temporary "one-for-one" policy, an owner of more than one Liberty vessel was permitted by the Maritime Administration to transfer one vessel foreign for each such

vessel it agreed to retain under United States registry. Where the owner of only one Liberty vessel desired to transfer it to foreign registry, approval of the transfer of registry for such vessel was granted only if the owner joined forces or "paired-up" with another owner of a Liberty vessel and the other owner agreed to retain its ship under United States registry.

7. In accordance with this temporary "one-for-one" policy, taxpayer agreed to retain four of its Liberty vessels under United States registry in order to permit the owners of four other vessels to transfer such ships to foreign registry. In return for its agreements temporarily to retain four of its seven Liberty vessels under United States registry Weyerhaeuser received, from the owners of the four vessels transferred foreign, the sum of $291,437.50. By retaining its ships under the American flag, Weyerhaeuser continued to use its Liberty vessels in the same manner as it had always done since their purchase before the "one-for-one" policy was put into effect, namely, under United States registry. There is no evidence in the record to show that Weyerhaeuser's shipping operations were in any way limited or restricted by its commitment agreements or that its business was in any way changed or altered by virtue of these agreements.

8. After the expiration of the "one-for-one" policy in December, 1954, retention agreements such as the four executed by Weyerhaeuser, were no

longer considered as binding by the Maritime Administration. After the expiration of this temporary policy, when a ship owner requested allowance to transfer foreign a vessel which had been committed to United States registry during the period of the "one-for-one" policy, it was given the same consideration by the Maritime Administration as was afforded to owners of vessels which had never been committed to United States registry during the temporary "one-for-one" policy. Owners of committed ships, such as Weyerhaeuser had the same privileges as to transfers foreign as did owners of non-committed ships, since each was treated equally and given the same consideration as to transfers foreign by the Maritime Administration.

9. Weyerhaeuser, at no time, transferred or otherwise disposed of any if its Liberty vessels during the period herein involved.

10. After the termination of the temporary "one-for-one" policy, Weyerhaeuser had the same rights with respect to the transfer foreign of its "committed" ships that it had prior to its entering into the "commitment" agreements and prior to the adoption of the "one-for-one" policy.

11. Under the "commitment" agreements, Weyerhaeuser agreed to use its ships only under United States registry until the "one-for-one" policy was terminated.

12. Under the "commitment" agreements, Weyerhaeuser agreed to forbear from requesting per-

mission of the Maritime Administration to have four of its Liberty vessels transferred to and used under foreign registry.

Conclusions of Law

1. This Court has jurisdiction of this action and the parties thereto.

2. The income tax deficiency assessed by the Commissioner of Internal Revenue and collected from the plaintiff for the taxable year 1954 was proper and no refund is due under the claim asserted in this action.

3. The presumption favoring the correctness of the Commissioner's assessment is fully supported by the facts and law material to this case.

4. The transactions involved in this action did not result in the sale or exchange of property, capital assets or property used in the plaintiff's trade or business within the meaning of Sections 1221 and 1231 of the Internal Revenue Code of 1954.

5. Plaintiff, by agreeing to retain its vessels in United States registry, thereby voluntarily restricted the use to which it could put its Liberty vessels.

6. Plaintiff received the amount of $291,437.50 in return for its agreement to forebear from applying to the Maritime Administration for permission

to have its Liberty vessels operated under foreign registry.

7. The payments received by the plaintiff for its agreements to retain its vessels in American registry constitute ordinary income within the meaning of the Internal Revenue Code.

8. The amounts received by the plaintiff under its retention agreements did not reduce the bases of the plaintiff's vessels.

9. The defendant is entitled to judgment in its favor dismissing plaintiff's complaint with prejudice and awarding defendant its costs and disbursements herein.

Dated this 17th day of March, 1961.

/s/ GEORGE H. BOLDT,
United States District Judge.

Presented by:

/s/ CHARLES H. MAGNUSON,
Attorney, Tax Div., Department of Justice.

Lodged February 14, 1961.

[Endorsed]: Filed March 20, 1961.

United States District Court, Western District of Washington, Southern Division

No. 2483

WEYERHAEUSER STEAMSHIP COMPANY,

Plaintiff,

vs.

THE UNITED STATES OF AMERICA,

Defendant.

JUDGMENT

The above-entitled action having come on for trial before this Court on November 17, 1960, sitting without a jury, the plaintiff and the defendant appearing by their respective attorneys, and upon consideration of the stipulation of facts in the pretrial order, the exhibits, the briefs and oral arguments of the parties, and the Court having rendered its memorandum decision on March 20, 1961, which opinion is made a part hereof by reference, it is hereby

Ordered, Adjudged and Decreed that plaintiff is not entitled to any recovery prayed for in the complaint and notation of the judgment having been entered in the Civil Docket pursuant to Rule 58, Federal Rules of Civil Procedure, on March 20, 1961, judgment is entered for the defendant dismissing plaintiff's complaint with prejudice and with costs, if any, to be assessed against the plaintiff.

Done in Open Court this 22nd day of March, 1961.

/s/ GEORGE H. BOLDT,
United States District Judge.

Approved as to form:

/s/ RICHARD K. QUINN,
Attorney for Plaintiff.

Presented and Approved by:

/s/ CHARLES H. MAGNUSON,
Attorney, Tax Division, Department of Justice;

/s/ CHARLES W. BILLINGHURST,
Asst. United States Attorney.

Entered March 20, 1961.

[Endorsed]: Filed March 23, 1961.

[Title of District Court and Cause.]

BILL OF COSTS

Judgment having been entered in the above-entitled action on the 23rd day of March, 1961, against Weyerhaeuser Steamship Company, the clerk is requested to tax the following as costs:

Bill of Costs

Fees of the clerk: $15.00 (Disallowed).
Attorney fees: $20.00 (Allowed).
Total: $35.00 ($20.00 Allowed).

United States of America,
Western District of Washington,
Southern Division—ss.

I, Charles H. Magnuson, do hereby swear that the foregoing costs are correct and were necessarily incurred in this action and that the services for which fees have been charged were actually and necessarily performed. A copy hereof was this day mailed to Richard K. Quinn, of Counsel for Plaintiff, 1201 Tacoma Bldg., Tacoma, Wash., with postage fully prepaid thereon.

Please take notice that I will appear before the Clerk to tax said costs on the 28th day of March, 1961, at 9:30 a.m.

/s/ CHARLES H. MAGNUSON,
Attorney, Tax Div., Department of Justice, Attorney for Defendant.

Subscribed and sworn to before me this 27th day of March, A.D. 1961, at Tacoma, Wash.

[Seal] /s/ INEZ V. CHAPMAN,
Deputy Clerk, U. S. District Court, Western District of Washington.

On objection of Plaintiff's Counsel to $15.00 item above costs are hereby taxed in the amount of $20.00 this 28th day of March, 1961, and that amount included in the judgment.

/s/ J. EDGAR MacLEOD,
Deputy Clerk.

[Endorsed]: Filed March 27, 1961.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that Weyerhaeuser Steamship Company, plaintiff above named, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the final judgment entered in this action on the 20th day of March, 1961.

Dated this 16th day of May, 1961.

/s/ DANIEL C. SMITH,

/s/ OLIVER MALM,

/s/ RICHARD K. QUINN,
Attorneys for Plaintiff.

[Endorsed]: Filed May 16, 1961.

[Title of District Court and Cause.]

COSTS BOND

Know All Men by These Presents,

That we, Weyerhaeuser Steamship Company, as principal, and United Pacific Insurance Company, as surety, are held and firmly bound unto The United States of America, in the sum of Two Hundred Fifty Dollars ($250.00), to be paid to the said United States of America, to which payment we bind ourselves, our successors and assigns, jointly and severally.

Whereas, on the 20th day of March, 1961, a judgment was entered in the above-entitled cause adverse to the plaintiff therein, and the said plaintiff has duly filed a notice of appeal to the United States Court of Appeals for the Ninth Circuit.

Now, Therefore, the condition of this bond is that if the said Weyerhaeuser Steamship Company shall pay all costs if the appeal is dismissed or the judgment affirmed, or such costs as the Court of Appeals may award if the judgment is modified, then the above obligation to be void, otherwise to remain in full force and effect.

Dated this 16th day of May, 1961.

[Seal] WEYERHAEUSER STEAMSHIP COMPANY,

By /s/ ROBERT W. BOYD,
Secretary.

[Seal] UNITED PACIFIC INSURANCE COMPANY,
Tacoma, Washington;

By /s/ EINAR N. BUGGE,
Attorney-in-Fact.

[Endorsed]: Filed May 16, 1961.

[Title of District Court and Cause.]

STIPULATION

It is stipulated and agreed by the interested parties to the above-entitled cause, by their respective counsel, that the attached retyped copy of the deposition of Walter C. Ford and exhibits therein included, taken October 28, 1960, at Washington, D. C., and filed in District Court on November 1, 1960, under District Court Clerk's document No. 8, and made a part of the record at time of trial, may now be made a part of the files and records of this cause in place of and with the same effect as the original of the deposition and exhibits aforementioned which cannot now be located.

Dated this 12th day of June, 1961.

/s/ RICHARD K. QUINN,
Counsel for Plaintiff.

/s/ DAVID J. DORSEY,
Counsel for Defendant.

ORDER

So Ordered this 14th day of June, 1961.

/s/ GEORGE H. BOLDT,
United States District Judge.

[Endorsed]: Filed June 15, 1961.

[Title of District Court and Cause.]

DEPOSITION OF WALTER C. FORD

Washington, D. C., Friday, October 28, 1960

Deposition of Walter C. Ford, called for examination by counsel for plaintiff, pursuant to notice, at Room 3059, General Accounting Office Building, 441 G Street, N.W., Washington, D. C., before Joe C. McLaughlin, a notary public in and for the District of Columbia, commencing at 3:05 p.m., when were present on behalf of the respective parties:

For the Plaintiff:

ROBERT S. HOPE, ESQ.

For the Defendant:

BURTON SCHWALB, ESQ.

Proceedings

Whereupon,

WALTER C. FORD

was called as a witness by counsel for plaintiff and, having been first duly sworn by the notary public, was examined and testified as follows:

Direct Examination

By Mr. Hope:

Q. Would you please state your name, address and official position with the Maritime Administration for the record? A. My home address?

Q. Yes, sir, please.

(Deposition of Walter C. Ford.)

A. Walter C. Ford, 148 Prince George Street, Annapolis, Maryland. Deputy Maritime Administrator.

Q. How long have you been with the Administration, sir? A. Seven years.

Q. On what date did you become Deputy Maritime Administrator? A. October 20, 1954.

Q. What was your position at the Administration prior to becoming Deputy Maritime Administrator? A. Program Planning Officer.

Q. In the course of your official duties are you familiar with the policies of the Maritime Administration with respect to the administration of sections 9, 37 and 41 of the Shipping Act of 1916 as amended?

A. Does that concern foreign transfers?

Q. Yes. I'm sorry to put it in the context of the [3*] law. It's the foreign transfer provisions of the Shipping Act of 1916. A. Yes.

Q. With respect to the administration of these foreign transfer provisions of the 1916 Act, are you familiar with the policies of the Administration which have existed since January 1, 1954, as to the transfer of Liberty-type vessels?

A. Yes.

Q. Would you please describe the policy which existed as to Liberty-type vessels prior to August 16, 1954?

A. Under the 1952 Trade-Out-and-Build policy,

*Page numbering appearing at top of page of original Reporter's Transcript of Record.

(Deposition of Walter C. Ford.)

if the U. S. owner constructed a replacement vessel, he could transfer Liberties foreign.

Second, a few Liberty dry-cargo vessels in early 1954 were approved in order to protect the Maritime Administration's collateral and financial interest in the vessels or due to the extreme financial hardship of the U. S. owners.

Q. That was early in 1954? A. Right.

Q. Would you please, Admiral Ford, identify for the record a document with the letterhead of the United States Department of Commerce, Maritime Administration, dated August 25, 1954, addressed to all U. S. owners of Liberty dry-cargo ships who have applications on file with the Maritime Administration for approval to transfer said ships to foreign ownership and/or registry, signed by Mr. C. H. McGuire? A. Yes.

Q. What is this document? Are you familiar with it? [4]

A. Yes. This was a notice to the owners on the subject which you just indicated.

Q. Does this accurately state the policy which was adopted by the Administrator on August 16, 1954? A. Yes.

Q. Would you please identify who Mr. McGuire was at the time?

A. Mr. McGuire was the Chief of the Office of National Shipping Authority and Government Aid.

Q. Was the August 16, 1954, action a change in policy as to the transfer of Liberty vessels?

A. A modification, not a change.

(Deposition of Walter C. Ford.)

Q. Would you summarize briefly for the record what the substance of that was?

A. This is known as the "Liberty dry-cargo policy." It permitted the transfer to flags of Liberia, Panama or Honduras with ownership to be in corporations of Liberia, Panama or Honduras which were U. S. citizen-controlled.

It also provided that for each Liberty dry-cargo vessel approved for transfer the owner file a letter with the Maritime Administration which committed one Liberty to remain under U. S. flag.

Q. Was this known as the "one-for-one" policy in colloquial terms? A. Yes.

Q. When did this so-called "one-for-one" policy terminate?

A. December 17, 1954, was the termination date for the receipt of applications. There were still some on file which were approved in January, 1955. [5]

Q. Would you please look at this press release numbered NR 54-72, captioned "Liberty Dry Cargo Transfers Suspended, for Immediate Release, Friday, December 17, 1954." Is this press release an accurate statement of the termination of the receipt of applications for this "one for one" Liberty transfer policy? A. I believe so.

Q. Let me ask this question: Were any applications under the "one for one" policy approved after January 31, 1955? A. No.

Q. I hand you, sir, a document captioned "Documentation, Transfer or Charter of Vessels, Reprint from Federal Register, Issue of November 8, 1956."

(Deposition of Walter C. Ford.)

Can you identify this document as the action taken by the Maritime Administrator with respect to foreign transfer policies? A. Yes.

Q. Attached to that are Amendments 1, 2, 3 and 4. Would you please identify these documents as amendments to this policy? A. Yes.

(The document above referred to, together with amendments, is appended hereto and made a part of this deposition.)

Q. Subsequent to the termination of the "one for one" policy, did the Maritime Administration consider the commitments made by the owners of Liberty-type vessels to retain their vessels under U. S. registry to be binding upon such owners? [6]

A. All applications for transfer of Liberty dry-cargo ships after December 17, 1954, were considered under the provisions of sections 9 and 37 of the Shipping Act, 1916, and no distinction was made between committed and uncommitted ships.

Q. In other words, you considered these applications on a case-by-case basis?

A. That's right.

Q. I will hand you a press release dated January 25, 1960, NR 60-12, "Maritime Amends Foreign Transfer Policy," for release Monday p.m., January 25, 1960. Are you familiar with this press release?

A. Yes.

(The press release above referred to is appended hereto and made a part of this deposition.)

(Deposition of Walter C. Ford.)

Q. Would you summarize briefly the change in the policy which was effected as outlined in this press release?

A. The modification of January 25, 1960, provided that Liberty dry-cargo vessels would be considered for foreign transfer without the need for replacement on the basis of the individual merits of each application and might be approved provided a determination was made that the vessel was not needed for retention under U. S. flag or United States ownership from the standpoint of national defense, the maintenance of an adequate merchant marine, foreign policy of the United States, and national interest.

There was no limitation as to the nationality of the foreign buyer or country of registry except that the buyer and country of registry had to be acceptable to the Maritime [7] Administrator.

Conditions were prescribed for Liberty dry-cargo vessels approved for transfer under the amendment of January 25, 1960. These conditions related to ownership, availability, change in registry and trading restrictions, which conditions were substantially in accord with conditions prescribed under the earlier policy of July 5, 1952, and December 15, 1953.

Under this policy of January 25, 1960, as under all announced policies after December 17, 1954, all Liberty dry cargo vessels under U. S. flag, committed, retained and uncommitted, were considered as in the same category and eligible for transfer

(Deposition of Walter C. Ford.)

foreign in accordance with the then prevailing policy.

Q. Admiral, during the period from December 17, 1954, to January 25, 1960, did the Maritime Administration permit the transfer of any committed Liberty vessels?

A. By the foreign transfer policy of 1956, as amended, adopted originally on November 5, 1956, the Maritime Administration permitted the transfer to foreign ownership and registry of certain types of U. S.-flag, war-built vessels, including Liberty dry-cargo vessels, provided the U. S. owner agreed to construct a replacement vessel of a larger size and faster speed.

Under that program our records indicate that the Liberty dry-cargo vessels American Starling, American Eagle and American Oriole, owned by American Foreign Steamship Company, were the first "committed" Liberty dry-cargo vessels approved for transfer, namely, on December 26, 1956.

During this period all Liberties, committed [8] or uncommitted, were treated alike insofar as transfers were concerned.

Q. In the last sentence of your answer there, do you mean with respect to the new construction program, the so-called Trade-Out-and-Build program? A. Trade-Out-and-Build.

Q. During this period did the Maritime Administration permit any committed Liberty vessels to be transferred without consideration of replacement under the Trade-Out-and-Build program?

(Deposition of Walter C. Ford.)

Do you follow my question?

A. I don't believe we permitted any transfers except under the Trade-Out-and-Build program during this period.

Q. Do your records show, Admiral, when the first approval was granted after January 25, 1960, for the transfer of a committed Liberty vessel which did not involve a commitment to construct replacement vessels? A. Yes. There were five:

Valiant Hope (ex-Ocean Ulla), approval date 2/26/60.

Ocean Seaman, approval date 4/15/60.

Oceanstar, approval date 3/18/60.

Irenestar, approval date 3/18/60.

Seastar, approval date 3/18/60.

Mr. Hope: That's all I have to ask the Admiral. Thank you very much, sir. I appreciate your indulgence.

Mr. Schwalb: Just one question.

Cross-Examination

By Mr. Schwalb:

Q. Since the termination of this "one for one" policy on December 17, 1954, has a committed vessel, a vessel [9] committed during that six-month period, ever been treated differently from a non-committed vessel?

A. What six-month period?

Q. That was the August 25 to December 17 period when the "one-for-one" policy was in effect.

(Deposition of Walter C. Ford.)

A. August, what year?

Q. 1954. A. To December?

Q. During that period when vessels were committed. Have those committed vessels since that time ever been treated differently from uncommitted vessels in respect to transfer foreign?

A. I don't believe so.

Mr. Schwalb: I have no other questions.

Redirect Examination

By Mr. Hope:

Q. Admiral, with respect to your answer to that last question, do you know whether any applications after December 17, 1954, for transfer of a committed Liberty vessel were denied by the Maritime Administration?

A. I don't know of any.

Would you mind repeating that?

Mr. Hope: Would you read that back, Mr. Reporter?

(Question read by reporter.)

The Witness: No, I don't recall of any being turned down if in accordance with the policy.

Q. (By Mr. Hope): Well, does that mean that you permitted the transfer of the committed Liberties only in connection with the November 5, 1956, policy, the Trade-Out-and-Build program? [10]

A. Well, I don't believe that we permitted any transfer except in accordance with the policy during that period.

Mr. Hope: That's all I have.

Mr. Schwalb: I have no other questions.

(Whereupon, at 3:25 p.m., the taking of the deposition was concluded.)

(Signature waived.) [11]

In the District Court of the United States for the Western District of Washington, Southern Division

No. 2483

WEYERHAEUSER STEAMSHIP COMPANY,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

TRANSCRIPT OF PROCEEDINGS

Transcript of Proceedings held in the above-entitled and numbered cause in the above-entitled court before the Honorable George H. Boldt, United States District Judge, on Thursday, November 17, 1960, at the United States Courthouse, Tacoma, Washington.

Appearances:

On behalf of the Plaintiff:

MR. RICHARD K. QUINN,

Attorney at Law.

On behalf of the Defendant:

MR. CHARLES H. MAGNUSON,
Attorney, Tax Division,
Department of Justice.

(Whereupon, at 10:30 o'clock a.m., Thursday, November 17, 1960, all counsel being present, the following proceedings were had, to wit:)

The Court: Good morning, gentlemen. Are you ready with Weyerhaeuser?

Mr. Quinn: We are, your Honor.

The Court: Go ahead.

Mr. Quinn: Your Honor, I will make just a very brief opening statement. I was not certain whether or not you had a chance to familiarize yourself with the case, but on the assumption that you have, I just wanted to hit the very highlights of the case.

The Court: I would be glad to have an opening statement. Go right ahead, Mr. Quinn.

Mr. Quinn: The question presented is whether or not the amounts received by the Weyerhaeuser Steamship Company, the plaintiff in this action, during the taxable year 1954 were, on the one hand as plaintiff contends, proceeds from the conversion of capital assets, or, as the government contends, ordinary income.

The case is a rather unusual one which arises out of the Maritime Administration's statutory authority [2*] to control the transfer of the American flag vessel to foreign registry, which contemplates

***Page numbering appearing at top of page of original Reporter's Transcript of Record.**

a sale of the vessel to a foreign corporation. The Maritime Administration prior to the taxable year 1954 had considered the statutory authority granted to it to be not one which vested absolute control in them with respect to transfer, such that there was a basic transfer right, but rather that it was vested with the authority to act in the interest of the national economy and defense with respect of the transfer. Consequently, prior to 1954, it had viewed applications for foreign transfer on a case-by-case basis, that with respect to each transfer it examined the merits of the particular application as to whether or not the particular vessel was needed in the American flag merchant marine, whether the economic effect on retaining it was such as to force the owners out of business.

There were a number of considerations. During 1954 the economic picture, as it faced the American flag owners, was such that they were unable to obtain profitable employment for the vessels. They just could not compete because of the difference in cost associated with operation of American flag vessels as opposed to costs of operation of foreign flag vessels. Consequently, to improve this picture for those owners, because many of them were being forced to sell their vessels at Marshal's sales, they were forced into [3] bankruptcy and what not, and the Maritime Administration on August 16, 1954, promulgated a new transfer program, and in essence this program permitted one foreign flag transfer if, on the other hand, an American flag owner agreed to keep his vessel in American registry. This

necessitated two owners getting together, if we are talking on the one hand of a person who owned only one vessel. His only method of obtaining approval for foreign transfer would be to tie up with an American owner.

The Court: The Senators call it "pair."

Mr. Quinn: Pair up with an American owner. Obviously if the American owner owned more than one vessel for each two owned, he could automatically get one vessel transferred for him.

Now, this program was in effect from August 16, 1954, until December 17, 1954. The reason that it was terminated was that during that period some sixty-nine vessels had been permitted to transfer to foreign flag registry under the program, and at that point the then Maritime Administrator in order to assure himself that there would still be a nucleus remaining of American flag vessels of the dry-cargo Liberty-type terminated the program.

During the program the plaintiff agreed and sold its rights to transfer foreign, which it had in the vessels [4] which it owned, sold those rights to several vessel owners. There were in this case four separate vessels involved, each in a different corporation, and as a consequence of this, they received the sum of $292,000. That is an approximation. As a result of the agreement to retain its vessels in American registry and giving up this property right to transfer because the commitments or agreements to retain were forever binding insofar as the owner was concerned, that resulted in a difference in value between the committed and uncommitted

vessels even prior to transferring to foreign registry.

The foreign ship under the foreign flag had a substantially higher market value.

As a result of the one-for-one program, when a vessel became committed, there was a difference in value then between the American vessels still available for foreign transfer and the American vessels which had sold this right and no longer were available for foreign transfer. They were bound to stay in American registry.

Now, this merely summarizes the factual highlights of what occurred. With respect to the law, and I just want to make brief mention of the position the plaintiff is taking in this case, is that it is our contention that the right to sell, transfer, or relocate property is a fundamental right with respect to ownership [5] of that property; that at no time had Congress evidenced an intent to appropriate that basic right. They merely superimposed an administrative agency to regulate whether or not you could exercise that right during certain periods of time.

Now, this right to transfer foreign, which is the basic property right about which we are talking in this case, is, in our mind, property used in the trade or business within the meaning of Code Section 1954, Code Section 1231, because it is one of the sticks associated with the ownership concept, which we will call the bundle of sticks doctrine of an asset, which is 1231 asset, being, namely, property used in the trade or business, that in transferring this

right to another vessel owner which perfects his right to transfer foreign, he needs to bring the two together in order to perfect his own right to get approval by the Maritime Administration, and transferring that, it is our contention that there is a sale of 1231 properly, namely, the right to transfer foreign which everybody had subject to regulations, which we then gave to the other vessel owner to perfect his right, and as a result of receiving the proceeds for the sale of this right, the Weyerhaeuser Steamship Company, plaintiff in this action, was a little bit perplexed as to how to proceed with reporting this [6] as a federal tax matter. It could have attempted to allocate some portion of the basis of the vessel to this right, some portion of the basis being when you buy the vessel, we will allocate some part of the cost thereof to the basic right to transfer, but because of our inability to do so, because at the time we purchased the vessel, it was an aggregate asset, we in our return, the plaintiff in its return instead treated the right as a return of capital, as is the case ordinarily with those capital transactions, where for failure of allocation of some portion of the basis to the particular property rights sold, you treat it as a return, and again the situation comes up at a later time when you dispose of the asset as a final disposition.

The plaintiff wants the Court to understand that it is always willing, just so long as this is treated as a capital gains transaction, it will always be willing to do whatever it can to attribute or allocate some portion of the basis of the asset to the right

and report the proceeds from the sale of that right over and above the amount allocated as capital gains.

This concludes my opening statement.

The Court: Thank you.

Mr. Magnuson, do you care to make your opening statement? [7]

Mr. Magnuson: May it please the Court, due to the magnitude not only of this particular case and of the amount involved in this case, but because of the principle involved in the interest of the Treasury Department and also the interest of the Attorney General, I would like to make an opening statement in that I may repeat some of the facts propounded by counsel. But if the Court permits, I will go ahead and do so.

The Court: Yes.

Mr. Magnuson: Under the Shipping Act of 1916, the Congress gave authority to the Secretary of Commerce to regulate the use of ships registered under American flag to foreign registry, and this act was implemented and promulgated through the Secretary of Commerce and through the Maritime Administration under this particular department.

In March of 1954, as shown by the exhibit in the pretrial order, there was information related to the Congress of the United States to the effect that there may have been certain controls exercised by the Maritime Commission. That was not in conformity with the Shipping Act. As a result of this hearing, a Mr. Rothchild, who represented the American Maritime Administration, presented the

views of the American Maritime Commission to the Senate. In this presentation he impressed the Senate with [8] the fact that in implementing the control over transfer of American vessels to foreign flags, that the Department of Commerce or the Maritime Administration did not in any way want to set a rigid plan of control; that their plan was one of flexibility, and in implementing this flexible plan, they would consider the national economy, the amount of maritime vessels then under American flag not only in numbers of vessels, but in total tonnage volume, and the interest of the country as far as national emergency or war emergency, and also give consideration to the individual owner as to the type of vessel that he owned, the economic situation tnat existed for him, and the interest to his concern as far as what business or what he engaged in as far as shipping.

In the same year on August 17 of that year, the Maritime Administration implemented a policy, which we will probably refer to in the course of this trial, as the one-for-one policy referred to by the counsel in his opening statement. As a result of this one-for-one policy the Maritime Administration would give favorable consideration to the transfer of an American vessel to foreign flag if there was a corresponding vessel available to be committed to American registry.

During the year 1954, the evidence will show that the plaintiff in this case was a steamship [9] company engaged in intercoastal trade, and at such time had some seven vessels that were of a dry-cargo

Liberty type, which were a wartime vessel built, I believe, some time in 1942 or '43. They were approach by other owners who wished to transfer their vessel to foreign flag, and under an agreement between the parties the plaintiff agreed to commit its vessel to American registry permitting the owner of the other vessel to apply to the Maritime Administration for approval to transfer their vessel to foreign flag. As a result of this transaction the plaintiff received an amount of money. It is this amount of money that is in issue in this case.

Now, it is the plaintiff's position that this was a sale—that it was a sale of property used in trade or business and that in addition, the amount received was a reduction in the basis of their vessels. The basis under the Code means cost, and if I might illustrate in terms of money, the cost of an item is naturally the amount of money expended for a particular piece of property. For example, if we were to use the figure $300,000 as the paid price for one of the vessels in this case, that would be the initial cost. If it were used for a number of years, the owner in all probability would make certain improvements and expenditures as to that vessel. Improvements as distinguished from repairs would also be [10] added to cost. So if we assume that during the period that they had the vessel that they put improvements of, say, another hundred thousand dollars, the cost for tax purposes would be $400,000.

Now, in addition to that, the cost for tax purposes, if they were to sell the vessel and determine

the gain thereon, their cost would be cost less depreciation taken over the years that that vessel was put into use. Assuming the fact that they depreciated the vessel for, let us say, a hundred thousand dollars for the period of use, their cost basis would then be $300,000 again. I hope I got the right figures there.

The Court: I followed you. I get the idea.

Mr. Magnuson: In this case they wish to treat the amount received not as a gain but an additional reduction in the basis of that property. In other words, deduct or subtract the amount received from their tax basis for income tax purposes, which would be a deduction of the amount received from the figure that I have mentioned, $300,000. Thereafter, when and if they do sell the vessel, the amount received above the basis would be treated as a gain from the sale or exchange of a piece of property used in the trade or business and treated as a capital asset under the Code.

The position taken by the defense in this case is that the treatment by the taxpayer that this is [11] a reduction in the basis is not supported by law nor the facts in the case, and in addition that there was no sale of property as property was used in the Code and under the legal decisions used in trade or business and in fact that the transaction did not result in a sale.

In addition, the plaintiff's position is that the amount received is in the nature of a compensatory reward, and in that respect it should be treated within the Section 61 of the Code as an income item

and as an income item should be treated for income tax purposes as the receipt of ordinary income.

Thank you, your Honor.

The Court: Thank you. Go ahead.

Mr. Quinn: At this time, your Honor, I want to point out one correction in the pretrial order, which appears at Page 4, Line 26, under the column "Vessel," which refers to the vessels of plaintiff in respect of which the amounts were received, we had the Ocean Skipper as the vessel involved. That is a misstatement. The Ocean Skipper is the vessel transferred foreign. The George S. Long is the vessel of plaintiff's which was committed.

The Court: I will strike the word "Ocean Skipper" and put in the words "George S. Long." Is that agreeable? [12]

Mr. Magnuson: Yes, your Honor.

The Court: I am writing that change in the margin, and I will initial it to indicate that it is my work. The pretrial order has been amended as suggested.

Mr. Quinn: In addition, at this time, before calling my first witness, I would like to introduce and offer in evidence the exhibits which are attached to the pretrial order on file in this case.

The Court: Is there any objection to any of them?

Mr. Magnuson: If it please the Court, I have just one objection insofar as the exhibits are used to support opinion evidence. However, pursuant to agreement between counsel, I will not object to hearsay nor the fact that they are the individuals

who made the statements with reference to Exhibits 7 and 8, but insofar as it is used by the plaintiff, if it is to be used in that way as opinion evidence, I so object.

The Court: If I understand the point of your remark, it is that as to Exhibits 7 and 8 you have no objection to their being admitted insofar as the factual data stated therein is concerned, but you do object with reference to any conclusions or opinions stated therein?

Mr. Magnuson: I believe Exhibit 9 would also fall in that category. [13]

The Court: 7, 8 and 9. Then in effect what you say is that 7, 8 and 9 may be admitted to the effect that these persons, if called upon, would testify to the factual data stated in their statements, but that you object to any opinions or conclusions drawn therefrom, is that correct?

Mr. Magnuson: Yes, your Honor.

The Court: Do you accept that?

Mr. Quinn: I accept that.

The Court: Exhibits 1 to 9, inclusive, offered by plaintiff are now admitted in evidence with the limitation as to 7, 8 and 9 just indicated.

(Thereupon, Plaintiff's Exhibits 1 to 9, inclusive, for identification were admitted in evidence.)

Mr. Quinn: I will now call my first witness, Mr. Connoy.

JOHN J. CONNOY

called as a witness on behalf of the plaintiff, being first duly sworn, was examined and testified as follows:

The Clerk: Please state your full name and spell your last name.

The Witness: My name is John J. Connoy, [14] C-o-n-n-o-y.

Direct Examination

By Mr. Quinn:

Q. Mr. Connoy, would you state your address, please, your home address?

A. My home address is 1601 Arroyo Avenue, San Carlos, California.

Q. What is your occupation?

A. I am assistant to the president of the Weyerhaeuser Steamship Company employed in San Francisco.

Q. And how long have you been so employed?

A. I have been employed by the Weyerhaeuser Steamship Company since 1937, and in the present capacity since 1957.

Q. What was your capacity with respect to the year 1954?

A. At that time I was assistant to the executive vice-president of the company, and at that time the president of the steamship company was not active in the day-to-day conduct of the business, and so, in effect, I was in the same position as I do now.

Q. Could you give us just a brief summary of the functions you performed in 1954 in connection

(Testimony of John J. Connoy.)

with your employment; that is, just as brief as possible describing your duties in a broad sense?

A. Well, my principal areas of responsibility were in the solicitation of westbound cargo, insurance matters, in [15] chartering activities, and such other matters as the vice-president would direct.

Q. Have you familiarity in conjunction with your duties with foreign transfer of American flag vessels? A. Yes, I have had experience.

Q. Can you state this experience?

A. Yes. In the years 1946 and 1947 shortly after the termination of the war, the Weyerhaeuser Steamship Company had four vessels remaining of its present war fleet of eight ships. Those vessels had been used, of course, under order of the War Shipping Administration during the war and were returned to us in rather poor condition because of the abuse they had to take during the war. The cost of putting those ships back into class, that is, in first-class operating condition, was such that we did not feel we could economically operate them. So the decision was made to dispose of the vessels. At that time the only market for those vessels was the foreign market. Those four ships were sold to foreign buyers and with a condition of the sale that the registry of the vessels would be transferred to foreign countries, and the vessels would sail under foreign flags, and as a part of my duties then, I handled the negotiations with the purchasers, the preparation or assisted in the preparation of the documents, and also I spent some time [16] in

(Testimony of John J. Connoy.)

Washington handling the details of arranging for the transfer, the necessary Maritime Administration approval of the transfer to foreign flag.

Q. Then you do have personal knowledge with respect to the foreign Liberty-type vessels market and mechanics of transferring such vessels to foreign ownership or registry?

A. If I may clarify your question, I just want to clarify that the ships that we sold in 1946 were not Liberty ships. Those were World War One vintage ships. But since then I have handled transactions with Liberty ships in the purchase of our present fleet and have kept familiar with ship values in the intervening years, and I have had experience in the transfer of ships to foreign registry.

Q. Will you describe for the Court briefly the nature of the business operations of the plaintiff in this action, Weyerhaeuser Steamship Company?

A. The Weyerhaeuser Steamship Company is a common carrier certificated by the Interstate Commerce Commission for operation in the intercoastal trade of the United States. In 1954 the company owned and operated seven Liberty-type dry-cargo freighters. The employment of the vessels is in transportation of lumber from the Pacific Northwest to the Atlantic Coast of the United [17] States in the range from Port Everglades, Florida, to Boston, Massachusetts.

For the return trip back to the Pacific Coast general cargo of all types and nature is solicited and loaded at the ports of Philadelphia and Balti-

(Testimony of John J. Connoy.)

more for discharge at the ports of Los Angeles, San Francisco and Seattle, and it is one hundred per cent domestic operation.

Now, in addition to the operation of our own vessels, the company has from time to time supplemented its eastbound service, chartered vessels from other people to carry lumber to the East Coast.

Q. As an American intercoastal steamship operator are there governmental restrictions, and I am referring now to the United States Government, as such through its various agencies, are there governmental restrictions placed upon the American intercoastal steamship operators with respect of the registry of vessels?

A. There certainly are. A vessel to qualify for operation in the intercoastal trade must first have been built in an American shipyard, and, of course, must fly the American flag. Ownership of that vessel must consist of at least 75 per cent of American citizens. A further restriction is that if a vessel, which has once qualified for operation in the domestic trade, is transferred to [18] a foreign register and then subsequently retransfers back to American flag, that vessel may never again be allowed to operate in the coastwise trade. The rights which it originally had have been destroyed by the transfer to foreign flag.

Q. Well, then, in connection with the Weyerhaeuser Steamship Company's operation in domestic trade, it was necessary to have available to it vessels which were qualified for such trade and as

(Testimony of John J. Connoy.)

such, from your testimony, were American flag vessels, is that true? A. That is correct.

Q. Now, you mentioned foreign transfer, and can you describe from your knowledge the—what "foreign transfer" means? That is, what does it involve and how is it effected under the Maritime Administration or other governmental agencies control with respect to those transfers?

A. Well, the first requirement, of course, has always been approval of the federal Maritime Administration and its predecessor agencies.

Secondly, in every case that I have had any knowledge of, the purchaser or the person who will operate the vessel under foreign flag has used a foreign corporation and has made application to the country of the flag under which it plans to operate for permission to [19] register the vessel in that country and with the approval of the Maritime Administration, the American registry of the vessel is surrendered and the new flag country will issue documents to cover the vessel.

Q. In other words, what is contemplated is a sale of the vessel? A. That is correct.

Q. To a foreign corporation, is that correct?

A. That is correct. That has been true in every case that I have known of.

Q. Now, with respect to the taxable year 1954——

The Court: Excuse me just a moment. I want to be sure I understood what you said, Mr. Connoy. Correct me if I am wrong. You say that under ex-

(Testimony of John J. Connoy.)

isting rules and the practice of the Maritime Commission, the United States Maritime Commission, that once a ship in domestic registry, and by "domestic registry" I mean American registry, be transferred to foreign registry, that ship may not thereafter be returned to domestic coastal trade and registry?

The Witness: No,

The Court: State it again so that I have it clear what you said.

The Witness: We have two situations with [20] American flag ships. In the domestic trade of the United States, which means the transportation of commodities or passengers between two states—two states of the United States, there are imposed further restrictions than are imposed upon American flag ships that operate from the United States in foreign commerce. If a vessel, which has once qualified under the full restrictions applying to domestic operations, and I may add that the common expression in the trade for a fully qualified vessel is that it has "coastwise rights," if a vessel with coastwise rights is transferred to a foreign flag, it at that time loses forever its right to engage in coastwise trade again.

Now, that vessel could be retransferred back to the American flag and engage in foreign commerce from the Port of Seattle to the Port of Yokohama under the American flag, but it could never again carry a pound of cargo from the Port of Seattle to the Port of San Francisco.

(Testimony of John J. Connoy.)

The Court: All right. That clarifies it. Go ahead.

Q. (By Mr. Quinn): You have mentioned——

A. I might add, your Honor, if I may, that that is a federal statute, not a ruling of the Maritime Administration. [21]

The Court: All right. Go ahead.

Q. (By Mr. Quinn): Now, with respect to the taxable year 1954, the year in issue in this case, and more specifically with respect to the period of August 16 through December 17 of that year, are you familiar with the then existing dry-cargo Liberty-type vessel transfer program as announced by the Maritime Administration? A. I am.

Q. Will you describe that program for the Court?

A. Well, the program, which, again, in the trade was known as the "one-for-one program," was announced by federal Maritime Administrator Rothchild on, I believe, August 16. Under this program——

The Court: What year?

A. 1954. Under this program owners of American flag Liberty vessels would be allowed to transfer one vessel to foreign registry for each vessel that they paired up with it and agreed to retain under American registry. That program—there were at that time some owners who owned only one vessel, and in order to provide for those owners, Administrator Rothchild, I believe, on August 25, 1954, stated that those owners should find someone else who owned one or more American flag Liberty ves-

(Testimony of John J. Connoy.)

sels and have the second owner agree to pair up one of his ships, and that then the first vessel would be allowed [22] to transfer foreign.

Q. (By Mr. Quinn): Can you describe how the Weyerhaeuser Steamship Company first became interested following the date that this program was announced in retaining its vessels—any of its vessels in American registry in connection with this program?

A. Well, as a part of my chartering activities I had for some years been in almost daily contact with Mr. Burton Kellogg, a ship and chartering broker of New York City, and in almost every case of the many charters that we arranged, they were arranged for through Mr. Kellogg.

In our almost daily conversations Mr. Kellogg would pass on to me any bits of information that he picked up about the ships' sale, market, charter market rates, and I believe that it was Mr. Kellogg that first brought to our attention that out of this pairing of two separately owned vessels, a market was beginning to develop in the exchange of the agreements of retention, and—if I may deviate for a moment, in 1954 the vessels of the Weyerhaeuser Steamship Company were ten years old. They were at the midpoint in their then believed to be economic life. One of our major concerns was at that time how we were going to replace those vessels at some time ten years away. Based on our previous experience with our first fleet, the [23] only logical market for the disposal of used Amer-

(Testimony of John J. Connoy.)

ican shipping was the foreign market, and we did not take any great interest in its market in letters of retention or agreement to retain because by committing our vessels to remain under American registry, we were in effect closing a door on what might be our only market for the disposal of those vessels when the time came that we had to replace them for our own trade.

However, as weeks went on, the market for the agreements reached a point where it appeared to us that the compensation for an agreement to retain was about equivalent to the penalty that we would take by agreeing to retain our vessels under the American flag, and when I say the penalty, I mean the difference that then existed between the value of an American—of an uncommitted American flag Liberty ship and a committed American flag Liberty ship. It was at that point that we negotiated for on the agreements that we entered into.

Q. Did you then consider that at the point at which the offers or retentions of agreements had reached a certain level, that the amount which would be received by the retention agreement was compensation for the loss of the right to ultimately dispose of the vessel on the foreign market? [24]

Mr. Magnuson: Objection, leading.

The Court: Sustained.

Q. (By Mr. Quinn): Can you tell us about the various offers you received for the retention agreements?

A. Yes. I will have to speak only from memory,

(Testimony of John J. Connoy.)

but shortly after—starting at about the first of September we received——

The Court: What year?

The Witness: 1954.

The Court: It is plain, but it reads better in the record when you state it.

A. (Continuing): We received several—in fact many offers, some of them came through Mr. Kellogg who had always acted as our broker, and the other came direct from other brokers, and who were then referred to Mr. Kellogg, and in one or two cases we had calls and inquiries from owners direct. At one period, I will say, we were almost hounded with offers. In fact, we had one offer—several offers from one individual who wanted to make a flat package deal for the retention of our entire fleet.

Q. (By Mr. Quinn): For how long a period did you consider the agreements of retention to be binding upon the Weyerhaeuser Steamship Company with respect of the vessels that it agreed to retain? [25]

A. It was our understanding at the time there was no time limit on it. They ran on indefinitely. So that we would be in effect binding ourselves for an unknown period.

Q. And Mr. Kellogg represented Weyerhaeuser Steamship Company with respect to the negotiations of these agreements of retention subject, of course, to the approval of Weyerhaeuser Steamship Company as principal?

A. That is correct.

(Testimony of John J. Connoy.)

Q. Can you tell us why the Weyerhaeuser Steamship Company did not execute agreements relating to all of its vessels?

A. Well, as I have said earlier, we anticipated that the only market for the disposal of our vessels ultimately would be the foreign market. We did not want to completely close the door of that market for all of our ships. That was our principal reason.

Q. Mr. Connoy, in connection with retention of all of Weyerhaeuser Steamship Company's vessels in American registry, did you have an offer with respect of the entire fleet?

A. Yes, sir, we did.

Q. Can you tell us a little bit about that offer?

A. Only that it was an offer for the fleet, a package deal. I forget what the opening offer was, but I do know that [26] at one time we were at a firm offer of $500,000 for letters of retention on the entire fleet, but it was not considered.

Mr. Quinn: I have no further questions.

The Court: Cross-examine, please.

Cross-Examination

By Mr. Magnuson:

Q. Mr. Connoy, you recall that we had a discussion yesterday morning at the Winthrop Hotel here in Tacoma? A. Yes, sir.

Q. And, as I understand it, as a result of that conference it is your—you recollect that the payees solicited the Weyerhaeuser Steamship Company in

(Testimony of John J. Connoy.)

connection with these retention agreements, is that correct? A. That is absolutely correct.

Q. And as a result of this solicitation to the Weyerhaeuser Company, those individuals or owners——

Mr. Quinn: Pardon me. I just want to point out I think there is an error in the record. Mr. Magnuson stated it was the payees who solicited——

The Court: I noticed that term. What do you mean by that?

Mr. Quinn: It would be the payor, the [27] payee being Weyerhaeuser Steamship Company.

Mr. Magnuson: Excuse me. It was the payor, if we wish to use that term.

The Court: In other words, what you mean is the person who paid Weyerhaeuser for this retention agreement, that is what you mean. Is that what you mean?

Mr. Magnuson: The party that wanted to get it.

The Court: The party that wanted to sell to a foreign registry.

Mr. Magnuson: Yes.

The Court: I noted that word and I was going to ask if you would explain what you meant.

Mr. Magnuson: Excuse me, your Honor.

The Court: Go ahead.

Q. (By Mr. Magnuson): And those individuals would then refer to your broker, Mr. Kellogg in New York City, who then negotiated with the brokers or owners of the other vessels as to the commitments that were finally entered into?

(Testimony of John J. Connoy.)

A. Yes, except that some of the inquiry came through Mr. Kellogg. They did not, all of the inquiries, come to us direct.

Q. So either direct or indirect, through Mr. Kellogg? [28] A. That is correct.

Q. And that it was Mr. Kellogg who finally drafted the agreements that the Weyerhaeuser Company—under which the Weyerhaeuser Steamship Company agreed to retain its vessels under American flag?

A. I do not know whether that is a correct statement or not.

Q. I thought that is what you said yesterday morning.

A. That Mr. Kellogg, himself, drafted those agreements——

The Court: Well, by him, or under his direction, or his offer.

The Witness: That came to us through him.

Q. (By Mr. Magnuson): Through him?

A. But who actually drafted them I don't know.

Q. And they were approved by your office in San Francisco? A. That is correct.

Q. And did your office in San Francisco request any advice from any other parties with reference to those particular transactions?

A. Well, now are you talking about the documents?

Q. The document, itself, the form of the substance of the document, itself.

A. Yes. I recall the first one was submitted to

(Testimony of John J. Connoy.)

the legal department here in Tacoma for their review and approval of the form. [29]

Q. And after having had their review and approval, it was then returned to Mr. Kellogg for final signing?

A. I believe, to be technically correct, that Mr. Kellogg was advised by phone that they had been approved, and they were then signed in New York by our vice-president in New York, signed for Weyerhaeuser.

Q. And you, yourself, were not a party to the final signing, it was your representative in New York, is that correct? A. That is correct.

Q. To the best of your knowledge, the agreements, themselves, represented the final agreement entered into by the parties?

A. Yes, to the best of my knowledge.

Q. And it represents, to the best of your knowledge, the rights and duties of each of the parties as to the transaction? A. Yes.

Q. Now, as I understand it, Mr. Connoy, the Weyerhaeuser Steamship Company is a company engaged in intercoastal trade, is that correct?

A. That is correct.

Q. And as engaged in intercoastal trade, it is required by law to retain its vessels under American flag? A. Right. [30]

Mr. Quinn: Objection.

The Court: Overruled. He gave a matter of law on the same point, and I must allow it. It is un-

(Testimony of John J. Connoy.)

common for a layman to give opinions on law, but it was permitted here, so I must permit cross.

Go ahead. In fact, I am anxious to find out the basis of his information. Go ahead.

Mr. Quinn: Withdraw the objection.

The Court: Ordinarily we don't allow laymen to give opinions on matters of law, Mr. Connoy. Don't be disturbed.

The Witness: This is my first time in the witness chair.

The Court: There is nothing personal in the remarks.

Q. (By Mr. Magnuson): Insofar as the Weyerhaeuser Steamship Company was concerned, it was not interested in using its ships under foreign flag?

A. Some consideration was given to a transfer of one or two vessels, some studies were made, but no action was taken on it, and it is true that we were not interested in operating under a foreign flag.

Q. Now, these vessels, as I recall, were acquired by the Weyerhaeuser Company—the vessels I am referring to, the seven that were owned by the Weyerhaeuser Company in [31] 1954—were acquired some time in 1953, is that correct?

A. Oh, no.

Q. Excuse me. When were they acquired?

A. Four of the vessels were purchased in 1947, two of them in 1948, and the seventh in 1951.

Q. Well, then at the time of acquisition the use of those vessels under foreign flag was not of con-

(Testimony of John J. Connoy.)

cern to the Weyerhaeuser Steamship Company. Would that be correct?

A. If I may, if I understand your question——

Q. If you don't, ask me to ask another one or say you don't understand. I will try to rephrase it.

A. I don't understand it.

Mr. Quinn: Immaterial.

The Witness: Could I rephrase it?

Mr. Magnuson: You rephrase it to suit yourself.

Mr. Quinn: I would like to have the Reporter read back the question.

> (Whereupon, the Reporter read back as follows: "Well, then at the time of acquisition the use of those vessels under foreign flag was not of concern to the Weyerhaeuser Steamship Company. Would that be correct?")

Mr. Quinn: I object to that as immaterial.

The Court: It may be, but I will let him answer in any case and decide that later. [32]

A. If I understand that to mean that at the time we purchased these vessels in 1947, and 1948, and 1951, that at each of those times we did not have in mind foreign operation at the time we bought the vessels, that is correct. There was no thought of foreign operation.

Q. (By Mr. Magnuson): By the Weyerhaeuser Steamship Company? A. That is correct.

Q. And that consideration was not used in the purchase of those vessels?

(Testimony of John J. Connoy.)

A. That is correct.

Q. Would it be fair to say, however, though, that consideration was given to the use of chartering these vessels to other owners?

A. That occurred in a few isolated instances when they were surplus for a period to the needs of our trade, and were then. I don't believe that at any time we had more than one ship at a time out on time charter for short periods to other American flag operators.

Q. Well—excuse me.

The Court: I think I didn't quite get the question. As I understand it, that did occur on this one occasion, perhaps some other, but the question was, did you contemplate that when you acquired it? Did you contemplate chartering out [33] for the use of others at the time the ships were acquired?

The Witness: Again, may I say that we did not buy the vessels with the thought of chartering them out to others as one of the reasons for buying them.

Q. (By Mr. Magnuson): It was contemplated you may charter out to other owners?

A. That is part of a normal operation of the business.

Q. That is right. That is all I wanted to find out, Mr. Connoy.

And in chartering out, it may be chartered out to an owner who would use it under foreign flag?

A. No, sir.

Q. Excuse me—use it in other than intercoastal trade? A. That is correct.

(Testimony of John J. Connoy.)

Q. And may use it in foreign trade?

A. Yes, but under the American flag.

Q. But under the American flag?

A. Correct.

Q. But as I understand it, no contemplated, no value was given to this use of the vessel?

The Court: No value given—what do you mean by that?

Q. (By Mr. Magnuson): At the time they were purchased, in [34] negotiating for the purchase, or in the acquisition of that vessel, did you or did you not give a value to this use that may be contemplated for that particular vessel?

A. I don't think it had any bearing on it.

Q. In other words, you didn't consider giving a value to that particular use? A. No.

Q. Now, you made reference to the fact that once a vessel had obtained a foreign flag it could never again return to American registry, is that correct? A. No, sir, I did not say that.

Q. Well, maybe I misinterpreted what you said.

The Court: He said it could return to American registry, but it could not thereafter engage in intercoastal trade.

The Witness: Yes.

The Court: It could be returned to American registry, but would be required to, by virtue of a federal statute that he didn't cite, but which I have no doubt is citable, would be permitted to engage in foreign trade but not in domestic. That is the way I understood it.

(Testimony of John J. Connoy.)

The Witness: That is correct, sir.

Q. (By Mr. Magnuson): At the time that the agreements were [35] entered into, was any consideration given, to your knowledge, by the Weyerhaeuser Steamship Company to salvage value of the particular vessel under the agreement?

A. Well, that is something that I have no knowledge of.

Q. You would not know?

A. No. It would not be——

Q. Was any consideration given to depreciation taken on that particular vessel?

A. That I would not know.

Q. You would not know that? A. No.

Q. Had the Weyerhaeuser Steamship Company, with reference to the vessels under the agreement ever applied to have those vessels transferred to foreign registry? A. No, sir.

Q. They had not? A. No, sir.

Q. Then it would be fair to say that the Maritime Administration had never turned down a request by the Weyerhaeuser Steamship Company to transfer those vessels to foreign flags?

A. We have never been asked to.

Q. And you found out they never would have to turn down such a request? [36]

A. We never had the opportunity.

Q. Now with reference to the contracts or the agreements involved, to your knowledge there is no restriction as to the sale of the vessel contained in the agreement entered into between the parties?

(Testimony of John J. Connoy.)

A. I don't understand.

Q. Well, I will ask it this way: Is there a restriction as to the sale of the vessel, itself?

The Court: The laid-up vessels?

Mr. Magnuson: The one committed to American registry.

The Court: Yes.

Mr. Magnuson: The ship owned by the Weyerhaeuser Steamship Company.

The Court: Of course, the document, itself, would be the best evidence of that, but I presume that is your point.

Mr. Quinn: Yes, your Honor.

The Court: But if it is prefatory to something you want to inquire about, the witness' knowledge of that could be brought out. But otherwise, the document will speak for itself.

Mr. Magnuson: I believe that is true, your Honor. I would just be mindful of the fact they had gone into the agreement, and I just wanted to [37] clarify for the record that this point was not set forth.

The Court: It is a nice point, but still it is—that will be covered by the agreement, itself, but sometimes the knowledge of a witness as to the contents of the document may be brought out as prefatory to some other inquiry or something of the kind. If you merely mean it for the fact of the matter, I must derive that from the document, itself.

Q. (By Mr. Magnuson): When this one-for-one policy was discontinued in December 17 of 1954,

(Testimony of John J. Connoy.)

did the Steamship Company treat this continuance as a gain to the Steamship Company, to your knowledge?

A. I don't believe it did, not to my knowledge.

The Court: When did you say that policy was discontinued?

Mr. Magnuson: December 17, 1954. I believe that is in the pretrial order.

The Court: Yes, it probably is, and it just skipped my attention.

Mr. Magnuson: No further questions.

The Court: Any redirect, Mr. Quinn?

Mr. Quinn: Just one point, your Honor.

The Court: Yes. [38]

Redirect Examination

By Mr. Quinn:

Q. Mr. Connoy, you have testified in response to Mr. Magnuson's questions that at the time the plaintiff executed its retention agreements it was not interested in foreign flag transfer with respect to its own vessels, that is, as to operation?

A. That is correct.

Q. However, did Weyerhaeuser Steamship Company regard the commitment as an important thing with respect to its vessels? In other words, it was interested in whether or not they were committed or uncommitted?

I don't mean to lead you, but I mean, wasn't this

(Testimony of John J. Connoy.)

a consideration with respect to the agreements, and can you explain why it was?

A. I am sorry, but——

The Court: He means, at the time this matter was negotiated, was the matter of whether or not Weyerhaeuser would or would not lay up its vessels or enter into the agreement a matter of substantial concern, and to what effect?

The Witness: Yes, it was, because——

The Court: That is your question?

Mr. Quinn: That is my question.

A. (Continuing): It meant, as I said earlier, agreeing to [39] retain under American flag registry for a period that was certainly indefinite and would have prevented our disposing of the vessels in the foreign market at some later date had we so desired.

The Court: Is that all?

Mr. Quinn: That is all, your Honor.

(Witness excused.)

The Court: Thank you, Mr. Connoy. You are excused and may leave.

Mr. Quinn: I would like to call Mr. Burton Kellogg.

BURTON W. KELLOGG

called as a witness on behalf of the Plaintiff, being first duly sworn, was examined and testified as follows:

The Clerk: State your full name, please, and spell your last name.

The Witness: Burton W. Kellogg, K-e-l-l-o-g-g.

Direct Examination

By Mr. Quinn:

Q. Mr. Kellogg, will you give us your home address?

A. 215 East Dudley Avenue, Westfield, New Jersey.

Q. And your office address? [40]

A. 19 Rector Street, New York City.

Q. And what is your occupation?

A. I am a ship and chartering broker.

Q. Can you give us a brief summary of your experience with respect to the shipping industry, particularly as related to your higher level educational background, your years of experience, the companies for whom you have worked, your knowledge of the shipping industry as such, and other related matters which you deem of importance in connection with your occupation?

A. I am a graduate of Colgate University in 1934. I served the firm of Emory Sexton and Company in January of 1939, and became and was instructed in chartering and ship sales matters, and began to negotiate as a broker in these matters.

(Testimony of Burton W. Kellogg.)

Now, a ship broker is one who tries to make a meeting of minds between two principals, sometimes with another broker in between. It is very much like a real estate broker, except we are dealing in a moving commodity and we are moving commodities.

In 1943, about April, I believe, I joined Perry Navigation Company, who was an operator of Liberty-type vessels during the war, and I served originally as in charge of their labor agreements with the crew and in the payroll end of the crew. By the time they [41] liquidated in 19—at the end of 1947 or early 1948, I was manager of the marine department. In July of 1948, I rejoined Emory Sexton and Company, Inc., which had been incorporated about 1946, April of 1946. I was a stockholder in the firm from the incorporation and vice-president, but was not active in it again until 1948. In 1954 I became president of the firm, and I am acting in that capacity up to now.

Q. You refer—just for clarification—you have referred to Emory Sexton and Company. Would you identify for the Court the nature of the business?

A. Emory Sexton and Company has been mainly dealing in ship brokerage and chartering activity and some agency work. Mr. Sexton established the firm in 1914. We are considered one of the smaller brokers, but one of the leading ones in the American field as far as chartering American flag and selling American flag.

(Testimony of Burton W. Kellogg.)

Q. Can you describe for us the nature of the work that you perform in conjunction with your duties? Put it from the period 1952 to date. Describe briefly what a ship charter or broker does.

A. Well, essentially we have to be up to date on the market conditions on values of ships, charter rates, and of course, it is our job to find for an owner a cargo if it is in chartering, and vice versa, for a shipper to [42] find a ship, and then negotiate between the two parties until there is a meeting of the mind and understanding and the contract is concluded.

In the ship sales it is very much the same, except you are dealing in a little more valuable property and you have more difficulty in working out the contract.

Q. In connection, then, with your duties as a ship charter and broker, do you have familiarity with the Maritime Administration's transfer programs respecting dry-cargo vessels?

A. We have to keep posted and up to date and be acquainted with those things as they would affect what we are able to do as brokers, and in order to conduct our business we have to follow them.

Q. Now, referring specifically to dry-cargo Liberty-type vessels, can you tell us the Maritime Administration's vessel transfer program as it existed prior to August 16, 1954? I mean, now, immediately preceding that date.

A. Well, immediately preceding that date there were two general programs that the Maritime Ad-

(Testimony of Burton W. Kellogg.)

ministration had. One was where an owner would agree to build newer type, larger type, modern type vessels in an American shipyard, the Maritime Commission would allow transfer of flag of a Liberty-type vessel. In some cases, depending on the size of the vessel to be built, there might be two [43] or even three Liberties permitted transferred for the building of these large tankers that were built at that time.

In the second program, it was strictly on the individual case and its merits and how it would affect the economy and the defense of the country.

Q. Referring to this latter, can you describe just very quickly just the mechanics of a vessel application for transfer prior to this August 16, 1954? How would you go about that?

A. There could be two ways, two types of transaction: One where an owner might be transferring it without a sale to another party, but through a corporation that he had interest in, foreign, and the other one an outright sale to a completely different group. Both mechanics would be handled the same. They would apply to the Maritime Commission, stating all the facts, the country that it is to go to, the persons involved, and then the Maritime Commission would look at these facts, would check with the State Department and check with the Navy Department as to whether they had any objection to the transfer, either because of who the people were or whether it would be detrimental to the defense

(Testimony of Burton W. Kellogg.)

of the United States to let a flag go out of American registry.

Q. Now, on August 16, 1954, the Maritime Administration [44] promulgated a new dry-cargo Liberty-type vessel program. Are you familiar with that program? A. Yes, I am.

Q. Can you describe the program and how it operated?

A. The program that came out originally described how an owner could pair his vessels together. If he had two or had four, half of his fleet could be transferred to either Honduran, Panamanian, or Liberian flag, and there were other detailed restrictions on this.

The Court: Do you mean by agreement to retain the others in lay-up status?

The Witness: Not in a lay-up, but permitted to stay in operation under American flag.

The Court: Yes.

The Witness: American registry. Then the question came up, what would happen to the owner with one ship or the owner with an odd number of ships, and it was later in the month, I believe, that they ruled that they could pair with other owners, and that the agreement between the two owners was not necessarily—what arrangements were made as to who transferred and who retained was of no particular interest to the Maritime Administration.

Q. (By Mr. Quinn): So, so long as there was one vessel [45] retained under American registry,

(Testimony of Burton W. Kellogg.)

the Maritime Administration would approve the vessel for transfer to foreign registry?

Mr. Magnuson: I object to the leading question, and I think, in addition to that, to be very clear in my point here——

The Court: Well, let counsel reframe it.

Mr. Magnuson: ——there is a conclusion in that question.

The Court: It may well be. Let counsel reframe it.

Mr. Quinn: I withdraw the question, your Honor.

Q. (By Mr. Quinn): How long was this program to which we have referred as the one-for-one program, how long was the program in effect?

A. It was in effect until, I believe it was December, middle of December, I can't recall the exact date, 16th, 17th, somewhere——

The Court: That same year?

The Witness: Same year, 1954.

The Court: August to December is the period in which it was in effect?

The Witness: Yes.

The Court: All right. [46]

Q. (By Mr. Quinn): Do you have knowledge as to how many vessels were transferred to foreign registry in connection with this program?

A. By acknowledgment of the Maritime Commission, there were sixty-nine vessels so transferred.

Q. What were the consequences of this transfer program with respect to the economic picture for

(Testimony of Burton W. Kellogg.)

steamship operators of either foreign, American, or in any manner you want to describe it?

Mr. Magnuson: I don't really fully understand the materiality.

The Court: It may well be, but I will take the proof and we will consider whether it is material later.

Mr. Magnuson: I object on that basis.

The Court: Yes, of course. Your objection is noted and quite properly so. I am not being critical of your making it. I merely say I will consider its materiality later, but I will let the proof go in.

The Witness: I don't quite understand.

The Court: What were the economic or financial results of this policy?

A. Well, the result created immediately a value for the rights to be paired with other owners. That was the [47] first effect.

The general effect for the American owner was that by transferring this number of vessels into foreign flag, that left fewer vesels to compete in the American market for business and tended to strengthen the charter market on American ships. Their support only came from these aid programs, really, as they couldn't normally compete with foreign flag vessels in the general market.

For the owners who transferred and had to maintain 51 per cent American under the regulations, this gave them some relief, as under the foreign market they had a chance to have a little better

(Testimony of Burton W. Kellogg.)

margin of profit than they would under American-flag conditions that existed before this program.

Q. (By Mr. Quinn): Now, you referred to two things in your answer which I believe bear some explanation for purposes of clarification, and you mentioned something about aid programs.

To what are you referring when you talk of an aid program?

A. Well, our aid programs are prettty well publicized. They have been under various names. Originally, the Marshall Plan was the aid program, and they have adopted a regular—Congress passed an act that 50 per cent of the aid programs be carried in American bottoms. The [48] 480 program is under the same condition. This is now operating under another agency name, I.C.A., and I have trouble remembering the exact name of what I.C.A. stands for at this minute.

Q. I wasn't actually asking that you give us the varied programs. You just mentioned it as "aid."

A. It is aid to foreign governments that we wish to support. It is a world political reason that I think all of us are acquainted with.

Q. And the aid programs with respect to carriage of goods, were they available to American operators? A. Yes.

Q. They were available?

A. They were available to—50 per cent of those cargoes were to move on American bottoms.

Q. So with respect to the transfer of vessels to

(Testimony of Burton W. Kellogg.)

foreign registry, were there fewer vessels then available for the aid programs?

A. Under the American flag, that is true.

Q. Now, another thing that you did mention in your answer, which I believe requires some clarification. Did you mention with restricted foreign registry something about 50 per cent ownership? I wonder if you could clarify what you mean by that with respect to the original owner and ownership following the sale of the vessel. [49]

A. Well, all transfers are subject to the Maritime Commission's approval and one of their requirements is that 51 per cent ownership in these one-for-one transfers remain with American owners. They didn't care if the original owner sold it to the other owners, as long as 51 per cent remained there, and also that they agreed to respect the restrictions of trading to certain countries in the world the same as American owners agreed to; that is, not to trade with Red China, North Korea, Russia, or any other place that might become unfriendly to the United States to a degree they restrict the Americans. These ships also were restricted from trading in those areas, and they were to be returned to use to the American government in case of war.

Q. But didn't it have to be the same owner?

A. It did not have to be the same owner, no, sir.

Q. As long as they were American?

A. As long as they were approved as reliable citizens.

(Testimony of Burton W. Kellogg.)

Q. Now, following termination of the one-for-one transfer program on December 17, 1954, do you have knowledge with respect to any further announcements by the Maritime Administration concerning agreements executed during the one-for-one transfer period?

A. During that time, after that until January of this year, I am not acquainted with any statement or order issued [50] from the Maritime Administration.

Q. What happened in January of this year?

A. In January of this year the Maritime Administration released——

Mr. Magnuson: Excuse me, your Honor. I don't know about this program and I don't know what he is going to talk about. I believe this is strictly hearsay and——

The Court: It is the kind of thing I would think is susceptible of proof by official documents. But I will allow the witness to refer to it, and then it can be documented later, if there is any question about it. In other words, if you find that there is no official documentation to this, then I will consider this and strike it from my consideration.

Mr. Magnuson: Thank you, your Honor.

The Court: You are welcome. Go ahead. In January of 1960 what happened?

A. (Continuing): January, 1960, the Maritime Administration issued an order which relieved—permitted transfer of Liberty-type vessels to foreign registry to friendly countries, the NATO countries

(Testimony of Burton W. Kellogg.)

and any other friendly country to the United States.

The Court: In effect, with that limitation [51] that you have mentioned, then, releasing the retention agreements pro tonto?

The Witness: This did, in effect.

The Court: In effect, would release those——

The Witness: Retention agreements.

The Court: Those under the obligation of the retention agreements from the effect thereof?

The Witness: Yes.

Q. (By Mr. Quinn): Now referring to the period of time that the one-for-one transfer program was in effect, namely, August 16, 1954, to December 17, 1954, it is our understanding from Mr. Connoy's testimony that you were employed by the Weyerhaeuser Steamship Company to represent it as agent with respect to the retention of several of its vessels of American registry, is that correct? A. As a broker, yes.

Q. As a broker? A. As a broker.

Q. Has your employment with Weyerhaeuser Steamship Company been a continuous one in that it antedated the one-for-one transfer program period?

A. Our firm sold ships to Weyerhaeuser back in the nineteen thirties. Some of the ones that Mr. Connoy mentioned were sold foreign. We have chartered in the early forties with them, and started again chartering [52] practically every year with them from, say, around 1950 onwards.

(Testimony of Burton W. Kellogg.)

Q. So in connection with your continual duties or employment relationship with the Weyerhaeuser Company, did you then inform personnel of Weyerhaeuser Steamship Company with respect to the retention agreement values?

A. Yes. As a matter of fact, I kept Weyerhaeuser completely posted as to the general market trend, the industries' attitude in regard to it, how they felt about it, and when sales of rights were made, and at what price.

Q. Was this a continuing situation of information exchanged between yourself and personnel of Weyerhaeuser Steamship Company?

A. Yes, practically daily. Sometimes several times a day.

Q. Now, with respect to the amounts which were offered for retention agreements, can you first of all give us a little idea about some of the values which were offered during this period insofar as you can recall?

A. There was a hesitation by the industry to do anything directly, and it was sometime in September before I recall hearing of an actual agreement sold, and at that time I believe it was about $32,000. After this occurred there were several pairings where owners had transferred their own ship without a letter or agreement of commitment without having bought a right, as they owned—they could [53] pair their own fleet. This used up a number of vessels that might be available to be committed to American registry and created a little

(Testimony of Burton W. Kellogg.)

tighter market, and the market gradually moved up until it was stabilized for a while around $60,000, and then went up into the high eighties for a short time.

Q. Now, speaking as an expert, which we believe we have qualified you as, do you have an opinion as to what factor caused a value to be placed upon the purchase of a right to the transfer of a vessel foreign by virtue of an agreement to retain?

A. Well, an uncommitted vessel immediately became more valuable than a committed vessel. For obvious reasons, it had the freedom and retained a freedom to sell in the foreign market, which is a much greater market than our American market, and when vessels become uneconomical in American registry, they can usually still find profitable employment under the foreign flag. So that definitely increased the value of the vessel.

As a matter of fact, in September of 1954 the J. Stevenson and Company sold a Liberty vessel for transfer by pairing with an owner for four hundred and ten thousand, while approximately at the same time another vessel that was committed sold for $365,000.

Q. Was there, then, a reasonable relationship or a relationship [54] between the amounts offered for retention agreements? A. Yes.

Q. As bearing upon the difference in value between the committed or uncommitted vessels?

Mr. Magnuson: Objection; leading, your Honor.

The Court: He may answer, I think. Go ahead.

(Testimony of Burton W. Kellogg.)

It is a little leading, but I won't take the time to have him reframe it. Go ahead.

A. Yes, there was a fairly reasonable differentiation between the committed and noncommitted vessels at about the figure of these retention agreements.

Q. (By Mr. Quinn): What was it that made the uncommitted vessels more valuable?

A. The uncommitted vessel was more valuable because it had a freedom to transfer to foreign flag, where you were restricted and restricted—any time you restrict the area in which you can sell a vessel, it is less valuable, and these were not restricted to strictly one market. They had the world market.

Q. Did the problem of ultimate disposal have any bearing? A. I beg your pardon?

Q. Did the problem of ultimate disposal of the vessel have any bearing on the difference in value?

A. Yes.

Q. Or a question, not a problem, but the question of disposal? [55] A. The ultimate——

Q. The point—I mean——

The Court: Start over again.

Mr. Quinn: I am sorry.

The Court: Back up and take another run at it.

Q. (By Mr. Quinn): Did the question which faced every owner of vessels—of a vessel with respect to its final disposition, have some bearing on the value which attaches to a committed or uncommitted vessel?

A. Yes. There is no question about that. It is

(Testimony of Burton W. Kellogg.)

the uncommitted vessel that could go into the foreign market, and after this situation existed, any negotiations we ever had in the sale, purchase and sales market, the very first thing a prospective buyer would say is, "Is this vessel committed or not committed?" They preferred to have the noncommitted vessel when they purchased and were willing to pay more for it than a committed one. There were a few exceptions of people who would gamble on the lower rate and keep it under American flag, but that gave it differentiation.

Q. Did this situation involving the difference in value exist for some time after termination of the one-for-one policy on December 17, 1954, and if it did exist, can you identify some transactions relating to the difference [56] and the dates on which they were consummated?

A. Yes. This did exist, and, as a matter of fact, I have knowledge of sales completed in September of 1956, possibly, and another one possibly early October, 1956. There were two vessels sold: The Western Trader in September at $850,000, and the Murray Hill at the same figure, with delivery in February, March, of 1957.

At the same time a prompt delivery on the Westport, a committed vessel. Incidentally, those two vessels were not committed. The Westport was a committed vessel and sold at $802,000 with a prompt delivery. You can figure that a future delivery like February or March, especially in a high market that existed at that time, is discounted over what we

(Testimony of Burton W. Kellogg.)

consider the spot market. No one would risk a top-of-the-market expenditure for future delivery.

At that same time there was a future delivery of a committed vessel, the Sea Monitor, that went for $750,000. That shows a differential between the Westport, which was sold for a prompt delivery at $802,000, and also at that time the Pacific Ocean was sold at $875,000 with an April delivery, which was the same delivery.

Q. Was that an uncommitted vessel?

A. That was an uncommitted vessel. [57]

Q. Then, in your opinion would there be a difference following the execution of the retention agreements respecting four of its vessels—would there have been a difference in market value between the Weyerhaeuser Steamship Company's four vessels that were agreed to be retained and the three that were not?

A. There would definitely be a difference in the market value for prospective buyers.

Q. Would that correspond to the differences which you noted in your testimony relating to a sale that occurred in 1954? A. Yes.

Q. In your opinion, would that difference have existed in late 1956?

A. It still existed, certainly, through 1956 and into 1957.

Q. And would that difference, in your opinion, although there are, of course, market fluctuations, would that difference have reasonably approximated the amounts received by the committors, those committing or agreeing to retain?

(Testimony of Burton W. Kellogg.)

A. That would fairly approximate it. It would run pretty much hand in hand.

Mr. Quinn: I have no further questions.

The Court: We will take the cross after lunch. Is there any other proof to be offered by either side? [58]

Mr. Quinn: There is none, your Honor.

The Court: Very well. And how long do you wish for oral argument?

Mr. Quinn: I would like to spend approximately a half hour.

The Court: All right. Would you check on the other case to follow and see if they can be prepared at midafternoon?

(Thereupon, the noon recess was taken.) [59]

Afternoon Session

The Court: Would you care to cross-examine?

Mr. Magnuson: May I ask a couple of questions, your Honor?

BURTON W. KELLOGG

having previously been sworn, resumed the stand and testified further as follows:

Cross-Examination

By Mr. Magnuson:

Q. Mr. Kellogg, do you agree with Mr. Connoy's understanding that a vessel once put under foreign flag would not then thereafter be allowed to engage in domestic trade within the United States?

(Testimony of Burton W. Kellogg.)

A. Yes, I do.

Q. Well, then, if an individual was in domestic trade, a vessel having a foreign flag would have no value to it at all, would that be correct?

A. If he was exclusively in domestic trade, that would be correct.

Q. When we talk about value, we have to look to the individual rather than saying as a generality. Would that be a fair statement?

A. No, I don't think that would be a fair statement, because [60] the trade is not where the value of the ship is as a ship sale proposition. That is where the value of the ship is if it is committed to stay American. It changes the value of the ship, so, therefore, that changes the value completely.

Q. Well, when we talk about value, we are talking about what value will be not only to a seller, but to a buyer? A. That is right.

Q. And a foreign flag vessel would have no value to a domestic shipper?

A. It would not to a domestic shipper, but it has a world market.

Q. Well, we are talking about other than a domestic shipper to other buyers that may have a different value, but it wouldn't have the same value, would that be correct?

A. Would you say that again?

The Court: Well, what you mean, in effect, is, if I understand you, is that a shipowner engaged purely in domestic trade would not be likely to be

(Testimony of Burton W. Kellogg.)

in the market for the purchase of a ship that was in foreign registry?

The Witness: Well, that would be correct.

The Court: Is that what you mean?

Mr. Magnuson: Yes, your Honor.

Q. (By Mr. Magnuson): And following that it would have no [61] value to that particular type of buyer?

A. Unless he was going to change his type of business, that is true.

Q. That is right, but if he was to be in that business and wanted to buy a vessel, that type of vessel would have no value to him?

A. That is right.

Q. Now, with respect to vessels under foreign flag, that type of a vessel would not be permitted to obtain American subsidies, would it?

A. No.

Q. And this may be a value, of value to an owner of a vessel under American flag?

A. An owner under American flag would have to apply for subsidy in a trade route, if that is what you mean.

Q. But it may be of value to him?

A. To have—it could be of value to him to have a subsidy, yes, sir.

Q. And if he had a vessel under foreign flag, he would not be permitted to do so?

A. He couldn't come under any of our subsidy laws.

Q. There are certain restrictions as to the type

(Testimony of Burton W. Kellogg.)

and quantity of cargo permitted—well, let me rephrase the question, please.

There are also United States restrictions on [62] the type and quantity of shipments of American goods from America with respect to the registry of a vessel? A. I am——

Q. Do you understand?

A. I think I understand what you are asking, but I don't think you are completely correct in that.

Under the aid program a certain percentage of cargo must go American. Under these aid programs that we had it was 50 per cent. The balance can go on foreign vessels of participating nations, any flag of any of the participating nations. Otherwise, if it is going to Italy, it can go on a French flag. It doesn't make any difference.

The Court: Well, I think what the importance of this question is, is that to the extent of 50 per cent that type of cargo must be borne in the American bottoms; that the opportunity of foreign bottoms to participate in that trade is thereby limited.

The Witness: To 50 per cent.

The Court: Is that about what you mean?

Mr. Magnuson: In part, yes, your Honor.

The Witness: It would be limited to the 50 per cent.

Q. (By Mr. Magnuson): And this also would be of value to [63] one who was engaged in that particular type of trade?

A. Which one are we talking about?

(Testimony of Burton W. Kellogg.)

Q. One carrying American goods.

A. The American flag, or do you mean the foreign flag?

Q. Well, the foreign flag would not be permitted to take in excess of 50 per cent, but only on permission by the Maritime Commission, would that be correct?

A. This isn't controlled by the Maritime Commission. It is controlled by other government agencies.

The Court: By whomever it is controlled.

The Witness: Yes.

Q. (By Mr. Magnuson): By a controlling agency?

A. Yes, but they are entitled to—that commodity is allowed to go 50 per cent of the quantity in foreign flag vessels.

Q. Well, you are talking about the aid program?

A. That is right. That is the only program that I know of with that limitation.

Q. That you know of that has a limitation? This is only as to particular countries, particular flags, under foreign flags?

A. The flags of countries participating in the aid program.

Q. And not all foreign flags? A. No.

Q. So exclusive—no, inclusive of those permitted to ship under the aid program, this would be a value of [64] them? A. Yes, that is true.

Q. And if a vessel was under a flag not within

(Testimony of Burton W. Kellogg.)

the aid program, that vessel would not be permitted under the aid program, if you follow me?

A. Only when there was no other vessel available and they could get a waiver, which is the exception.

Q. And there is that possibility?

A. That is right.

Q. So again we look to the value of a vessel to a particular owner or user. Would that be a fair statement? A. Yes.

Q. And all these have an economic effect upon the vessel and its use?

A. Yes, I think it does.

Q. Now, when you represented the Weyerhaeuser Steamship Company under the arrangement where they executed these agreements for committing their vessel to American flag, you did not make any independent examination of the particular vessels involved, is that right?

A. No. I normally, as a broker, would not examine the vessel in any case.

Q. Well, in this case you did not? A. No.

Q. And in this case you were not interested in physical [65] characteristics of those particular vessels?

A. No, sir, other than that they are Liberty type, American owned.

Mr. Magnuson: No further questions.

The Court: Any redirect?

Mr. Quinn: Only one question, your Honor.

(Testimony of Burton W. Kellogg.)

Redirect Examination

By Mr. Quinn:

Q. Did the fact of availability have value even to one engaged exclusively in coastwise trade?

Mr. Magnuson: I will object; leading and conclusive.

The Court: It is in form subject to that objection. However, he may answer. I think he will answer according to his views, despite the suggestions given to him in the question.

The Witness: I wish you would rephrase that. I didn't understand it.

The Court: Of course, that is what I should have asked for.

Q. (By Mr. Quinn): Perhaps I can rephrase it this way: To a steamship operator engaged exclusively in intercoastal trade, did the fact that the vessel could qualify for foreign transfer have some value? [66]

A. Yes, definitely it had a value. If it was free to transfer, it opened up a wider market.

The Court: You have covered that on direct pretty well.

Mr. Quinn: I got it the first time.

That is all, your Honor.

The Court: That is all. Thank you, Mr. Kellogg.

(Witness excused.)

The Court: Anything further in the way of evidence?

Mr. Quinn: No, your Honor.

The Court: Either side? Both parties rest?

Mr. Magnuson: No, your Honor. I was waiting for them to say they rest.

Mr. Quinn: We rest.

The Court: All right.

Mr. Magnuson: If it please the Court, I would like to move to make a part of the record the depositions taken by the plaintiff of a Mr. Ford who is a member of the Maritime Administration, and have that testimony of that deposition included in the record.

Mr. Quinn: We join in that, your Honor.

The Court: Very well. I take it that it is [67] agreeable that I read it myself without the formality of your reading it to me?

Mr. Magnuson: No, your Honor, unless you wish me to.

The Court: Either one of you may emphasize or talk about anything that is in it in your argument or otherwise, but if you agreed, I will read it and that can be done much more readily and quickly than by having it formally read back and forth, if you agree.

Mr. Quinn: Satisfactory, your Honor.

The Court: I will read the deposition in full and deem it a part of the testimony in the case to the full extent as though read into the record at this time.

Mr. Magnuson: No further evidence.

The Court: Defendant rests as well. Very well. I think you have agreed that a half an hour a side

should be adequate for the oral argument. You may proceed to do that.

Mr. Quinn: In closing, your Honor, now that the deposition to which we have just referred is part of the record, might I state that in support of Mr. Kellogg's statement that the Maritime Administration formally acted following the termination [68] of the one-for-one program in December of '54, as a matter of formal announcement, is contained as an exhibit in the deposition? At this time, as I understand it, it now becomes a part of the record, it is identified there.

I am offering this as support for Mr. Kellogg's statement with respect to a formal announcement.

The Court: Yes, I see it here.

Mr. Quinn: In closing I want to spend just a little bit of time on the facts which are established by the testimony in this case. I will not refer to the admitted facts. I am trying to save time.

The right to transfer foreign insofar as the Maritime Administration is concerned, was a valuable property right which inhered in the ownership of a vessel. Now, irrespective of whether or not the Maritime Administration is in a position to talk about something as a property right within the meaning of law in general is not that to which I am referring. I am saying insofar as the Maritime Administration was concerned, they felt that the right to transfer foreign was a basic property right. It inhered in the ownership of a vessel. All the Shipping Act of 1916 did was give them authority [69] when the national economy and defense dictated

otherwise to control the transfers. This is supported by Mr. Rothchild's statement as contained in the record in what has been identified as pretrial Exhibit No. 7.

Secondly, in implementing its considerations with respect to whether or not it would allow vessels to transfer, it did on August 16, 1954, promulgate this new transfer program. It did this, and again this is phrased in terms of Mr. Rothchild's press release, which has been identified as pretrial Exhibit No. 1. It did this to alleviate a very bad financial situation which faced American flag operators, that following a four-month period during which some sixty-nine vessels were allowed to transfer, the financial conditions or problems that faced these owners had been somewhat removed because foreign flag operators had been allowed to transfer out and get the benefits of being foreign flag operators—excuse me, American flag operators had been allowed to transfer out and get the benefit of foreign flag operation, at the same time cutting substantially the amount of American flag Liberties that were available to participate in the aid programs that were available. This is set forth in the termination announcement, press release, relating to the press release of the one-for-one policy, which has been identified in the record. [70]

Now, I think that Mr. Connoy has supported our contention that a steamship operator, such as Weyerhaeuser Steamship Company, while it was not interested in operating as a foreign flag vessel owner or operating in the foreign commerce or

foreign trade, it nevertheless was most interested in where it would finally dispose of these assets at the end of their economic life. It obviously had to have available to it a market place in which to dispose of these vessels.

Now, by agreeing to retain its vessels in American registry insofar as it was aware perpetually, it automatically foreclosed itself from disposing of a vessel in the foreign market. Now we are talking in terms not of the use of the vessel but of the ultimate sale of the vessel. This was the thing which attaches value to a coastwise operator in the availability of his vessels for foreign transfer, and for that reason, when it gave up this right and sold it to another so as to perfect his right to transfer foreign, it had to look to the compensation which was paid for the purchase of that right to offset the loss to the owner of the foreclosure of one of its ultimate market places for disposal.

It is on this basis that we contend that there has been a sale of property; namely, the basic property right inhering in a vessel to alienate such vessel freely [71] without restraint, and that in so disposing of this property right it found itself in a situation where it knew that it would not be able to dispose of the vessels at all when and if the time occurred that at the date of disposal there was no market. So it had to look to this compensation to offset two things: The loss of the market and the loss of the tax treatment which it could have received had it sold its vessels at the time the Maritime Administration opened up the one-for-one pro-

gram, because Weyerhaeuser Steamship Company under the one-for-one program could have sold three vessels to foreign registry. It could have taken advantage of the tax benefits which would have inhered in that transaction because that would have been a capital transaction.

So, what we are contending, and we believe this is supported in the record, is that in giving up this right and selling it to another, it was taking in advance of an ultimate disposal a portion of the gain that would have resulted to it had it gone out then and sold its vessels to foreign owners, and we are couching—or I should say we have always looked at this transaction in the sense that what was received is in effect part of the gain which would have resulted from the sale of the vessel. It is just a routine way of taking now what you could have gotten had you decided to sell. Now, this fact of agreeing to retain [72] and sell this property right immediately resulted in a difference in market value, which has been testified about this morning, and at a difference in value which existed not only during the one-for-one program, but which existed at least with respect to the testimony as late as some two years, plus, afterwards. I think this supports the contention that a property right was sold; that one of the sticks is gone.

This vessel in the market place now, if it is a committed vessel, just doesn't have the same value as the uncommitted vessel, despite the fact that they are both still American flag vessels. There has to be a reason, and that reason is that one of the prop-

erty rights respecting the vessel is gone, and the industry attached value of that property right, as demonstrated by what they were willing to pay for the two kinds of American flag vessels.

Now, I think that the difference in market value also demonstrates another point; that at the end of the one-for-one program on the termination date the Maritime Administration said nothing in its press releases respecting the agreements of retention that have been executed. They said nothing about the Liberty-type vessels until January of 1960. At least insofar as the trade is concerned, the commitments or letters of retention or [73] agreements of retention, no matter what terminology we want to use, were considered by the industry to be binding upon the owners.

On December 17, 1954, it did nothing to the vessel owners who had agreed to retain their vessels in American registry. It purely said, "We will no longer consider any more applications under the one-for-one program." So, at least I think it is established in the record, I believe it is established in the record, that the commitments or agreements or letters respecting which a property right had been sold were binding upon the owners or the vessels, themselves, if they were transferred among American owners throughout at least a two-year period following 1954, or at least until 1960, when the Maritime Administration formally acted otherwise.

I think that that is about as far as I need go in summarizing the facts. I think this is the essence

of the transactions insofar as the plaintiff is concerned. It has been our contention that, at all times, that the plaintiff gave up a basic property right, and the reason that that is a sale of the property right is because it was necessary for the one seeking foreign transfer to perfect his right by demonstrating he purchased, in effect, the other vessel owner's right in order to perfect his own right to transfer foreign. There is a transfer of [74] property between the owners, and it is not a promise not to do something. It may, in terms of the agreement—the agreement, of course, is couched in terminology of buy and sell. It is recognized this doesn't bind the Court. You can look to the substance rather than the form. So you have to examine the transaction, and it is our position that the vessel owner seeking foreign transfer had to purchase somebody else's right to perfect his own right, and there was a transfer which occurred between the parties.

Now, we have set forth in our brief the authorities upon which we rely. I am not going to go through all of the cases, because I know the Court will be familiar with those, or is already. I think that perhaps I would like to take just a few moments to talk in terms of what I think to be a case which is fully in support of our position and to talk a little bit about the government's position with respect to the transactions.

Just to sum up our own position, we feel this is a property right. It is a Section 1231 property right. That there has been a sale, and that this is a capital transaction resulting from the conversion of a cap-

ital asset. That is almost an aside with respect to what you do with it, once having established that.

I will sum up at the end, but right now I am [75] trying to get through the main issue, which I think in the case is whether or not this is a capital transaction. Now, as contained in our pretrial order and as contained in our brief, the government's position, I think, is summed up in Revenue Ruling 58-296, the citation to which is in both the pretrial order and the brief.

Now, this ruling talks in terms of the rights as being temporary privileges created and suspended by administrative action of a governmental agency.

Now, I submit that the Internal Revenue Service in promulgating this regulation misapprehended the effect of the one-for-one transfer program in that the Revenue ruling is couched in terminology of something which on August 16, 1954, was created.

Well, if we are to believe the exhibits that have been introduced into evidence and the testimony which has been given here since the beginning of time insofar as the American Merchant Marine is concerned, you always had the right to transfer your vessel to whom you pleased, and all that the Maritime Administration does, of course, it is a supervising agency to regulate that right as the dictates of the economy and defense should indicate; that on August 16, 1954, nothing magic occurred in the sense of creating a right where none existed. It purely said, "We have a very bad financial situation facing all [76] American flag owners. We want to do something about this to free some

of the vessels for foreign flag operation as foreign flag operators. Consequently, we are going to put into effect an almost automatic program."

So it created nothing. It merely clarified something, or brought into the forefront something which had been heretofore examined on a case-by-case basis.

The second point in the Revenue ruling that is quite bothersome to us is that it talks in terms of "the thing," if we want to call it "the thing," purchased by the payor as being something of value which attaches to the ownership of his vessel, as if to say, "You, Mr. Payor, bought something at the time you purchased somebody else's"—we will call it agreement to retain—"and this is property, and we are going to have you add that to the cost basis of your vessel."

But, on the other side they turn around and say to you who sold it, "You really haven't done anything, because it is only a temporary privilege that was created and suspended. You haven't given up anything. So you have got to treat it as ordinary income."

The overtones of having your cake and eating it, too, which exist in this ruling, are, we think, fairly obvious.

Now, it is recognized, of course, that you do [77] have situations in tax law where you can have a capital acquisition on one side and an ordinary income transaction on the other side. But these situations involve those cases wherein the person who must treat it as ordinary income has, in effect,

rendered some service. I am thinking in terms, now, of the cases where there is a covenant not to compete, purchased at the time you purchase a going business, and that is, forebearance from competing, is, in effect, a service which he renders to the purchaser of the business; and despite the fact that the purchaser must capitalize that expenditure, insofar as the recipient is concerned, it is payment for something which he does not do or does do, depending on how you want to look at it.

So, I think this is, the effect we get from this ruling is that there is a feeling on the part of the Internal Revenue Service that we are rendering some service. Excuse me. When I talk of "we," I mean the steamship company is rendering some service when we don't try to transfer our vessels foreign.

The answer to that one is that we couldn't. We, the steamship company, couldn't transfer vessels foreign, even if we wanted to break our promise, because the right, once it is sold, is gone. The Maritime Administration wouldn't even consider an application once you have committed your vessel to remain. So, once you have entered [78] into this agreement, there is nothing upon which you could be called upon to do or not to do with respect to the right to transfer foreign. It is gone. You have no recourse but to live with your agreement, and your compensation must compensate you for what you gave up as a result of selling that right.

In our situation, Weyerhaeuser Steamship Company as a coastwise operator, we gave up the right

to dispose of our vessels in the foreign market. The payments received were compensation for this. They represent part of the gain we could have recognized had we been those who sell those ships at that time. We have foreclosed ourselves from one market and we have given up a right. We must sell our vessels in the American market, even though we know five years later the Maritime Administration released us from those obligations. We must look at this as of the year during which it occurred, and at least for two years, plus, afterwards we have demonstrated there was a difference in value, had we sought to sell our ships then, and what happens in subsequent years, of course, can explain things that have happened during the taxable year. But they aren't determinative of what happened in the taxable year. So, insofar as Weyerhaeuser Steamship Company is concerned, when it executed its agreement, sold its rights, for all it knew it could have been perpetually bound to [79] its agreement throughout the balance of the economic life of its vessels.

Now, secondly, the government relies on the Terminal Steamship Company case, which is cited in the brief, both briefs. As a matter of fact, it was a tax court decision which was very recently decided, substantially the same, or I should say the issues involved are the same, were substantially similar facts, except that in the Terminal Steamship Company case, the person seeking to treat the proceeds from a sale of its agreement to retain had only one vessel; would have had no right to transfer foreign

unless it paired up with another owner. This is a factual distinction, but we are making not a real note of the fact there is a factual distinction, because we think in that Terminal Steamship Company case the court misapprehended the effect of the one-for-one termination announcement in that the tax court in that case concludes that on December 17, 1954, everybody was back where they started from; that on that date apparently, the way the tax court looks at it, the commitment of agreements, letter of retention, agreements of retention, were no longer binding. You obviously had, well, they even assume you have given up a property right and you got it back on December 17, 1954. We submit that this just is not the case.

Our testimony supports the fact that at least for [80] two years, plus, or more, following the termination of the one-for-one program the commitments, agreements, continued to bind the owners who had executed them; that you were not back where you started from on December 17, and you didn't get back where you started from until the Maritime Administration took a formal position with respect to releasing the vessels from their obligations.

The third case or third thing to which I want to refer briefly in my remarks is that the government has relied somewhat in its brief, and it has been cited in our own brief, on the Gillette case, which is a recent United States Supreme Court case. There is some language in that case used by Mr. Justice Harlan that would lead one to conclude

that the type of thing involved, which is not at all like what is involved in this case, but talking in terms of these various species of rights which are not given capital gains consequences, he seems to talk in terms of this particular—a particular right in this case, the right to use property as not being a capital asset.

Now, of course, we factually distinguish the Gillette case from our own in that we are not talking about the right to use property, we are talking about the right to ultimately sell property. But the Gillette case is correctly decided, despite some of the broad-reaching statements contained in the decision or opinion. It is correctly [81] decided because in that case the motor company, which had been seized temporarily during World War Two and for which the motor company had been compensated for the loss it suffered as a consequence of government operation, the Gillette Company received nothing but the rental value of its facilities, which would have been ordinary income had it been forced into a lease situation, which is in effect what occurred in that case. There had been an involuntary lease, and even the ordinary income which that company earned during government control was left in the business and credited against the final award made by the government. Mr. Justice Harlan says that, in effect, this would have been rental income, "had you leased your facilities to somebody else." It would have been ordinary income if it were rental income.

So, even though we are talking in terms of a

temporary seizure which has capital asset overtones, conversion of capital asset overtones, nevertheless we look through the form of the terms used by the various governmental agencies and what not that were involved and look to see what actually happened; and all that happened was that somebody came along and took your facility for a ten-month period, and in taking that facility, albeit involuntarily, you would have received rental income and, therefore, despite the fact that this is a seizure [82] argued to be treated as such under Section 1231, you received nothing other than rental income, and it would be ordinary income.

Now, the case on which we rely to a great extent is the Louis Ray case which is cited in our brief. The court of appeals in considering that decision was, I should say seemed to be so impressed by the tax court opinion that it adopted it almost in toto, and, therefore, you have a taxpayer lessee who, in negotiating the lease, had received from the lessor a promise or covenant not to lease the balance of the premises which the lessor owned to a competitor. About two years before the lease expired, the lessor wished to sell the premises to another, but his prospective purchaser said, "I don't want this because of this negative covenant. I don't want to be restrained from whom I can lease the balance of the premises."

The lessor then went to the lessee and said, "What will it cost for you to give me back that promise?" And the lessee finally agreed to $20,000. The question is now, what do you do with the $20,-

000? Well, the lessee in that case had nothing other than a right to enjoy a monopoly. That is the way I like to look at it. And in considering giving up that right to a monopoly, he decided that $20,000 would compensate him for the release of that right to a monopoly, probably in the sense of profits, [83] taking the place of lost profits, and so forth. So he relinquished his right, and in relinquishing that right, the tax court said that one is property, albeit only a right relating to use of property it is still property. The relinquishment is a capital transaction, and that there has been a sale or transfer within the meaning of the capital gains and assets and property transaction provisions of the Internal Revenue Code.

Well, to me I think the case, although it is not, of course, by any means on all fours with our own, it is quite analogous in that we relinquished a right to sell our vessels in the foreign market, and in so relinquishing that right to put it back over here, the one who sought foreign transfer, there was a transfer, and there was a transfer of property, and, at least according to the tax court opinion and the Louis Ray case would have been treated as a capital transaction. This to me, from research that's been done in connection with the case, is the closest case that I can find to what we have before the Court today.

I want to emphasize, and I want to save just a few minutes for rebuttal, I want to emphasize that we have here no service to be rendered in connection with our agreement to retain. The steamship

company agreed to retain our vessels in American registry. There was nothing [84] further for anybody to do, and while it might look like a promise not to do something, it also went further in its effect on barring you from the foreign market. So, you had given up something, not only in the sense of a promise not to do something, but you had given up one of the avenues available for ultimate disposition of your vessel. This right went over to the other vessel owner, who sought it to perfect his right for foreign transfer. So, within the language of the Louis Ray case to the Weyerhaeuser Steamship Company there has been a sale of property use in the trade and/or business within the meaning of Section 1231.

The Court: Thank you, Mr. Quinn. Mr. Magnuson?

Mr. Magnuson: May it please the Court, in viewing the position taken by the plaintiff in this case, the defense feels that its position belies its own weakness in that the plaintiff does not say that there is a sale, but that the transaction with which we are concerned in this case is a substitute for a sale. In that respect the defense feels that this supports its contention that not only was there a sale in this particular situation, but there was not a sale of property, and following that there was not a sale of property used in a trade or business. It appears that principally a contention supporting a reasoning that there is a sale is based upon a conclusion [85] that the transaction resulted in something that would be a permanent bind upon the

use, transfer, sale, or whatever the steamship company wished to do with its particular asset, the vessels in question. And with this I suggest to the Court that we have a finding of fact which the Court will find from a reading of the transactions themselves, the agreements, which the defense feels does not in any way support its conclusion that the execution was one of permanency, but rather was executed under the policy then set out by the Administration, by the Maritime Administration.

Also, in the wording or the testimony of the deposition taken by the taxpayer of Mr. Ford of the Maritime Administration, he made or emphasized that the commitments, whatever they may be, did not—it was my interpretation of his testimony did not have effect after the December 17 date, and that after that date uncommitted or committed vessels were treated on the same basis, although he did go further to state that no committed vessel was permitted to go to foreign flag, I believe, until some time in the year 1956. However, he did further state that no vessel committed to American registry had applied for foreign flag until that time, nor to his knowledge had one been denied transfer to a foreign flag during the period up to the first request for approval for a transfer [86] of a committed vessel to a foreign registry.

With respect to the law in this case, the defense submits that we must look at these transactions and distinguish that which is a use from that which is a transfer of property, and feel that in this case not only was there not a sale, but that the amount

of money received by the taxpayer represented something other than receipt from the sale or exchange of property, and as such should be treated as ordinary income.

I might say at this time that all the theories presented on behalf of the plaintiff have not been answered by our brief, and with that I would like to request the Court that we be permitted time in which to file and answer or reply to many of the theories raised during the course of this trial and in their briefs submitted prior to the commencement of the case before the Court. With that I only request the Court to recognize our position and recognize that we feel that the issue in this case is one in whether or not there was a sale and that there was a sale; whether or not there was a sale and whether or not there was a sale of property. And we urge upon the Court that there is no showing either by the testimony or by the agreements or by the pretrial order that there was a sale of property which would permit them to treat this sale as a sale of asset used in trade or business within the [87] meaning of Section 1231 of the Internal Revenue Code of 1954.

Thank you, your Honor.

The Court: Would you like to reply, Mr. Quinn?

Mr. Quinn: Just to one point with respect to Mr. Magnuson's argument. He refers to Admiral Ford's testimony as contained in the deposition, which does talk in terms of transfers of committed vessels allowed during the period subsequent to the termination of the one-for-one program prior to January of this year.

I merely want to point out to make it clear that Mr. Kellogg's testimony, his initial testimony was that there were two transfer programs in existence throughout this period. They have been identified in our brief, but just to bring it to the Court's attention, one of the programs relates to a trade out and build situation where you agree to replace the vessel transferred to foreign registry in an American shipyard with new construction.

Throughout this period, this avenue of transferring a vessel foreign we believe to be available to persons who owned Liberty vessels. I merely wanted to point out that the transfers of committed vessels which occurred, I think, in late fall of 1956, which is set forth in the deposition, were under that other program; that they were not release of committed vessels free of commitment to [88] replace the vessels transferred in American shipyards.

With respect to the filing of a brief, the only thing that the plaintiff desires is some time in which to respond.

The Court: How much time do you want, Mr. Magnuson?

Mr. Magnuson: If I might for safety ask for thirty days, I would appreciate it.

The Court: Well, I see no reason why you shouldn't have it, unless you see some reason.

All right. You can take a like period for any reply that you may wish to make, although I suspect you won't need that much. But if you do, you will have it, or you might get tied up with something else.

Incidentally, when you submit your brief, I wish you would along with it submit your proposed findings, serve them. That will give the plaintiff's counsel an opportunity to supply counter proposed findings. Make your proposed findings on all the data that is stipulated, and so on, in such a form as not to require a redo of that material as far as you can. Then when the memoranda are submitted and the proposed findings are submitted, that will minimize further concern after the Court decides the case.

Is that clear? [89]

Mr. Magnuson: Excuse me, your Honor. It may well be that we might wish to have portions of the transcript or the whole transcript. Could that thirty days commence after the receipt of that?

The Court: If you order it right now, if you order it in the next day or two.

Mr. Magnuson: Yes, your Honor.

The Court: In other words, I don't want to wait thirty days to order and then——

Mr. Magnuson: No, I didn't have that in mind.

The Court: I knew you didn't, but provided you order it within a few days, why, the thirty days will run from the time you get the transcript.

It is a very interesting case and very interesting question presented, and I will enjoy working on them and examining all of this material much more closely than I have had an opportunity to do thus far.

Recess subject to call.

(Whereupon, the court recessed subject to call.) [90]

Certificate

I, Gerald J. Popelka, official court reporter in and for the United States District Court, Western District of Washington, do hereby certify that the foregoing transcript of proceedings is a full, true, and correct transcript of proceedings had in the within-entitled and numbered cause in the above-entitled court on the date hereinbefore set forth.

I do hereby certify that the foregoing transcript of proceedings has been prepared by me or under my direction.

/s/ GERALD J. POPELKA.

[Endorsed]: Filed December 6, 1960.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK TO RECORD ON APPEAL

United States of America,
Western District of Washington—ss.

I, Harold W. Anderson, Clerk of the above-entitled Court, do hereby certify that pursuant to the provisions of Rule 75(o) of the Federal Rules of Civil Procedure, and Subdivision 1 of Rule 10 as amended, of the United States Court of Appeals for the Ninth Circuit am transmitting herewith such of the original papers and pleadings and exhibits in the above-entitled Cause as are designated by the parties hereto, and the said papers and plead-

ings and exhibits herewith transmitted constitute the Record on Appeal from that certain Judgment of the above-entitled Court filed and entered on March 23, 1961, to the United States Court of Appeals for the Ninth Circuit at San Francisco, California, are identified as follows:

1. Complaint (and exhibits A through F attached thereto).
2. Answer.
3. Pretrial Order dated October 17, 1960.
4. Pretrial exhibits 1 through 9.
5. Deposition of Walter C. Ford taken at Washington, D. C., on October 28, 1960 (Verified copy substituted).
6. Transcript of proceedings held November 17, 1960.
7. Stipulation dated December 8, 1960, correcting transcript of proceedings.
8. Memorandum Decision by District Court.
9. Findings of Fact and Conclusions of Law.
10. Judgment.
11. Bill of Costs.
12. Notice of Appeal.
13. Costs bond.
14. Stipulation & Order substituting copy of Deposition of Walter C. Ford for original Deposition.
15. Designation.

I do further certify that the following is a true and correct statement of all expenses, costs, fees and charges incurred in my office on behalf of the

parties hereto for the preparation of the Record on Appeal in this cause, to wit:

Notice of Appeal (Plaintiff), $5.00, and that said fee of $5.00 has been paid to the Clerk by Plaintiff.

In Witness Whereof I have hereunto set my hand and affixed the official seal of said District Court at Tacoma, Washington, this 19th day of June, 1961.

[Seal] HAROLD W. ANDERSON,
Clerk;

By /s/ [Indistinguishable],
Deputy.

[Endorsed]: No. 17436. United States Court of Appeals for the Ninth Circuit. Weyerhaeuser Steamship Company, Appellant, vs. The United States of America, Appellee. Transcript of Record. Appeal from the United States District Court for the Western District of Washington, Southern Division.

Filed June 20, 1961.

Docketed July 10, 1961.

/s/ FRANK H. SCHMID,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 17436

WEYERHAEUSER STEAMSHIP COMPANY,

Appellant,

vs.

THE UNITED STATES OF AMERICA,

Appellee.

STATEMENT OF POINTS

Pursuant to Rule 17(6) of the Rules of the Court of Appeals for the Ninth Circuit (U. S. Ct. of App., 9th Cir., Rule 17(6), 28 U.S.C.A.), the points upon which the appellant intends to rely on appeal in this cause are as follows:

(1) The District Court erred in its finding of fact:

"It was within the power of the Maritime Administration to withhold the privilege of a shipowner to transfer its vessels to a foreign registry." (Finding of Fact No. 4; Findings of Fact and Conclusions of Law, page 2.)

(2) The District Court erred in its finding of fact:

"In return for its agreements temporarily to retain four of its seven Liberty vessels under United States registry, Weyerhaeuser received, from the owners of the four vessels transferred foreign, the

sum of $291,437.50." (Finding of Fact No. 7; Findings of Fact and Conclusions of Law, page 3.)

(3) The District Court erred in its finding of fact:

"After the expiration of the 'one-for-one' policy in December, 1954, retention agreements such as the four executed by Weyerhaeuser, were no longer considered as binding by the Maritime Administration. After the expiration of this temporary policy, when a shipowner requested allowance to transfer foreign a vessel which had been committed to United States registry during the period of the 'one-for-one' policy, it was given the same consideration by the Maritime Administration as was afforded to owners of vessels which had never been committed to United States registry during the temporary 'one-for-one' policy. Owners of committed ships, such as Weyerhaeuser, had the same privileges as to transfers foreign as did owners of non-committed ships, since each was treated equally and given the same consideration as to transfers foreign by the Maritime Administration." (Finding of Fact No. 8; Findings of Fact and Conclusions of Law, page 4.)

(4) The District Court erred in its finding of fact:

"After the termination of the temporary 'one-for-one' policy, Weyerhaeuser had the same rights with respect to the transfer foreign of its 'committed' ships that it had prior to its entering into

the 'commitment' agreements and prior to the adoption of the 'one-for-one' policy." (Finding of Fact No. 10; Findings of Fact and Conclusions of Law, page 4.)

(5) The District Court erred in its finding of fact:

"Under the 'commitment' agreements, Weyerhaeuser agreed to use its ships only under United States registry until the 'one-for-one' policy was terminated." (Finding of Fact No. 11; Findings of Fact and Conclusions of Law, page 4.)

(6) The District Court erred in its finding of fact:

"Under the 'commitment' agreements, Weyerhaeuser agreed to forebear from requesting permission of the Maritime Administration to have four of its Liberty vessels transferred to and used under foreign registry." (Finding of Fact No. 12; Findings of Fact and Conclusions of Law, page 4.)

(7) The District Court erred in its conclusion of law:

"The income tax deficiency assessed by the Commissioner of Internal Revenue and collected from the plaintiff for the taxable year 1954 was proper and no refund is due under the claim asserted in this action." (Conclusion of Law No. 2; Findings of Fact and Conclusions of Law, page 5.)

(8) The District Court erred in its conclusion of law:

"The presumption favoring the correctness of the Commissioner's assessment is fully supported by the facts and law material to this case." (Conclusion of Law No. 3; Findings of Fact and Conclusions of Law, page 5.)

(9) The District Court erred in its conclusion of law:

"The transactions involved in this action did not result in the sale or exchange of property, capital assets or property used in the plaintiff's trade or business within the meaning of Sections 1221 and 1231 of the Internal Revenue Code of 1954." (Conclusion of Law No. 4; Findings of Fact and Conclusions of Law, page 5.)

(10) The District Court erred in its conclusion of law:

"Plaintiff received the amount of $291,437.50 in return for its agreement to forebear from applying to the Maritime Administration for permission to have its Liberty vessels operated under foreign registry." (Conclusion of Law No. 6; Findings of Fact and Conclusions of Law, page 5.)

(11) The District Court erred in its conclusion of law:

"The payments received by the plaintiff for its agreements to retain its vessels in American registry constitute ordinary income within the meaning of the Internal Revenue Code" (Conclusion of Law No. 7; Findings of Fact and Conclusions of Law, page 5.)

(12) The District Court erred in its conclusion of law:

"The amounts received by the plaintiff under its retention agreements did not reduce the bases of the plaintiff's vessels." (Conclusion of Law No. 8; Findings of Fact and Conclusions of Law, page 5.)

(13) The District Court erred in its conclusion of law:

"The defendant is entitled to judgment in its favor dismissing plaintiff's complaint with prejudice and awarding defendant its costs and disbursements herein." (Conclusion of Law No. 9; Findings of Fact and Conclusions of Law, page 5.)

(14) The District Court erred in failing to find and conclude that the Maritime Administration, acting pursuant to the powers conferred upon it by Sections 9 and 37 of the Shipping Act of 1916 (U.S.C. Title 46, Sections 808 and 835), has continuously treated the control granted it by Congress over foreign transfers of American flag vessels as a restraint upon the exercise of a property right inhering in the ownership of a vessel and not as a grant of absolute power to confer or withhold the privilege of foreign transfer.

(15) The District Court erred in failing to find and conclude that the Maritime Administration, in terminating its "one-for-one" foreign transfer policy, did not release any of those vessel owners including appellant, who had executed retention

agreements, from the obligation of retaining the vessels in United States registry.

(16) The District Court erred in failing to find and conclude that no dry cargo Liberty-type vessels respecting which retention agreements had been executed were permitted to transfer to foreign registry, without replacement thereof by new construction in an American shipyard, until January 25, 1960.

(17) The District Court erred in failing to find and conclude that as a consequence of the execution of a retention agreement, which effected a bar until January 25, 1960 (permanently so far as appellant knew on the date its agreements were made), to sale of the committed vessel in the foreign market, there was a substantial difference in value between committed and uncommitted vessels reflecting the adverse effect of limiting the sale of these vessels to the American market, which difference continued long after termination of the "one-for-one" transfer policy.

(18) The District Court erred in failing to find and conclude that one of the property rights inherent in the ownership of any asset is the right to sell or otherwise relocate such asset and that the right to transfer a vessel to foreign registry is such a property right.

(19) The District Court erred in failing to find and conclude that appellant, in executing agreements retaining four of its dry cargo Liberty-type

vessels in United States registry pursuant to the Maritime Administration's "one-for-one" transfer policy, sold property governed by the provisions of Section 1231 of the Internal Revenue Code of 1954.

(20) The District Court erred in failing to find and conclude that in computing its Federal income tax liability for the taxable year 1954 appellant is entitled to treat the payments received for retaining its vessels in United States registry as proceeds from the sale of property used in the trade or business and held for more than six months within the purview of Section 1231 of the Internal Revenue Code of 1954.

(21) The District Court erred in failing to find and conclude that because no part of the basis of any of appellant's vessels is allocable to the property sold, appellant, in its return, is entitled to apply the receipts in reduction of the basis of vessels respecting which agreements were made.

(22) The District Court erred in failing to find and conclude that on its claim for refund of income tax paid for the taxable year 1954, appellant is entitled to a judgment against appellee in the sum of $185,834.60, together with interest thereon at the rate of 6% per annum from December 23, 1958, as provided by law.

Dated this 5th day of July, 1961.

/s/ RICHARD K. QUINN,
Attorney for Appellant.

[Endorsed]: Filed July 6, 1961.